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Supreme Court, U.S.
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IN THE

Supreme Court of the United States

ALFRED D. HUGHES AND EL PASO HOLDING CORPORATION,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The United States Court of Appeals for the Federal Circuit, which has exclusive jurisdiction over cases arising under this Court's decision in *United States v. Winstar Corp.*, 518 U.S. 839 (1996), has developed a theory of contract law that binds a private party to a contract with the government when the sole consideration provided by the government is a promise to regulate in a certain manner *only for long as it chooses to do so*. The questions presented are as follows:

1. After a contract has been entered between a private party and the government, may the government use a boilerplate clause generally requiring compliance with all rules and regulations to force upon the private party an ancillary agreement that contains a provision depriving the private party of the specific consideration it had contractually bargained for and thereby making the contract illusory?

2. In deciding whether, as a matter of contract interpretation, to import the terms of the regulatorily-required ancillary agreement into the basic contract, was it error for the Federal Circuit to ignore the rule against interpreting contracts to avoid illusory promises – the very rule endorsed by Justices Scalia, Kennedy and Thomas in their concurrence in *Winstar*?

LIST OF PARTIES

Petitioners Alfred Hughes and El Paso Holding Company were the only appellees in the court below. Respondent United States of America was the only appellant in that court.

LIST PURSUANT TO RULE 29.6

Petitioner El Paso Holding Company, created in the 1980s by petitioner Alfred Hughes, is no longer in business.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners Alfred D. Hughes and El Paso Holding Corporation respectfully submit this petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit.

OPINIONS BELOW

The opinion of the court of appeals, Pet. App. 1a, is reported at 498 F.3d 1334. The initial opinion of the Court of Federal Claims on summary judgment, Pet. App. 16a, is reported at 58 Fed. Cl. 291. The opinion of the Court of Federal Claims entered after trial, Pet. App. 72a, is reported at 71 Fed. Cl. 284.

JURISDICTION

The judgment of the court of appeals was entered on August 29, 2007. Pet. App. 1a, 15a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

INTRODUCTION

The Federal Circuit's decision in this case is another step in a series of adjudications that have marginalized this Court's decision in *United States v. Winstar Corp.*, 518 U.S. 839 (1996), and represents an astonishing departure from established contract principles in order to benefit the government over private parties. In the course of its analysis, the Federal Circuit dismissed Justice Scalia's concurrence in *Winstar*, joined by Justices Kennedy and Thomas, as a "minority view" of the law of consideration. It erroneously read the plurality decision in *Winstar* to depart from deeply-rooted

contract principles and to sanction an agreement by the government to grant a regulatory forbearance for only so long as the government chose to grant it. Moreover, and equally significant for those who contract with the government, the court conflated general regulatory requirements with specific, bargained-for consideration: the court ruled that once a government contract contains seemingly innocuous language obligating the private party to conform with all applicable regulations and rules, these regulations can require the private party subsequently to enter into ancillary agreements that eliminate the only consideration it received in the primary contract. Through these two aberrant rulings, the Federal Circuit frustrated the obvious intent of the parties, which was that the government was bound by its promise concerning supervisory goodwill. These rulings are not supported by any decisions of this Court, and certainly not by *Winstar*. Yet they are now the law that the Federal Circuit and the Court of Federal Claims will apply in all future cases involving private parties who contract with the government.

In an increasingly regulated society, citizens must rely upon the courts to prevent established contract jurisprudence from being eclipsed by regulatory concepts that undermine the parties' intentions. That is especially true where private parties are encouraged by the government to put their own financial resources at risk to further a public goal. The government's campaign to undermine *Winstar*, not only with respect to the rules governing consideration and contract formation, but in a host of other areas of law including the law of remedies, will make all citizens who would otherwise contemplate entering into commercial contracts with the

government reluctant to do so. Such a result harms the government's "own long-run interest as a reliable contracting partner in the myriad workaday transactions of its agencies." *Winstar*, 518 U.S. at 883; *see also id.* at 913 (Breyer, J., concurring). Certiorari is clearly warranted. In light of the court of appeals' misapplication of *Winstar*, its utter disregard of basic contract law, and the thoughtful analysis of the experienced trial court judge who reached a correct decision after a full trial, the Court may wish to consider summary reversal, thereby reinstating the trial court's judgment.

STATEMENT

A. In *Winstar*, this Court chronicled the fate of savings and loan institutions in the 1980s, including the insolvency of many thrifts and the efforts of the federal government to induce private citizens to use their own resources to help support insolvent deposit insurance funds. At the time of the crisis, the Federal Savings & Loan Insurance Corporation ("FSLIC") lacked sufficient funds to liquidate all of the failing financial institutions and pay their insured depositors.[1] Accordingly, the Federal Home Loan Bank Board ("Board") encouraged healthy financial institutions, and individuals, to invest private funds and recapitalize failing thrifts through a series of "supervisory mergers." *Id.* at 847.[2] As the

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[1] The FSLIC was at all relevant times a separate entity under the direction of the Federal Home Loan Bank Board. *See* 12 U.S.C. § 1725(a) (1984). It administered a fund that insured the deposits held by thrift institutions. *See* 12 U.S.C. § 1726 (1984).

[2] During the period relevant here, Congress had "delegated power to the Board expressly for the purpose of creating and regulating federal savings and loans so as to ensure that they would remain financially sound institutions able to supply

Court recognized in *Winstar*, "the principal inducement for these supervisory mergers was an understanding that the acquisitions would be subject to a particular accounting treatment that would help the acquiring institutions meet their reserve capital requirements imposed by federal regulations." *Id.* at 848. This inducement permitted the new thrift to characterize the shortfall between the failing thrift's assets and liabilities as "supervisory goodwill," an intangible asset that counted toward the new thrift's capital requirements and, amortized ratably over an extended period of years (here, 25), gave the new owner a reasonable period of time to earn profits that should, over time, systematically replace the annual goodwill amortization. *Id.* at 849. Supervisory goodwill was thus "critical to make the transaction possible in the first place, because in most cases the institution resulting from the transaction would have been insolvent under federal standards if goodwill had not counted toward regulatory net worth." *Id.* at 850. The goodwill forbearance was "the subject of express arrangements between the regulators and the acquiring institutions." *Id.* at 853.

When Congress enacted the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), it knowingly violated the contracts that

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financing for home construction and purchase." *Fidelity Fed. Sav. & Loan Ass'n v. De la Cuesta*, 458 U.S. 141, 168 (1982). *See* 12 U.S.C. § 1464 (1984). Congress required that Board approval be obtained before any insured thrift institution could acquire or merge with another insured institution. *See* 12 U.S.C. § 1730(q)(1) (1984). Accordingly, under the applicable regulations, an acquiring institution had to submit to the Board an application for approval of an acquisition, merger, consolidation, or change of control of a thrift. *See* 12 C.F.R. § 546.2(c) (1984).

the banking agencies had entered into with private parties. *Winstar*, 518 U.S. at 856-57 (plurality opinion). Once deprived of supervisory goodwill, numerous thrifts freshly capitalized with private sector assets were unable to comply with regulatory capital requirements and instantly became insolvent. The statute's impact was, as this Court observed, "swift and severe." *Id.* at 857. Such was the fate of El Paso Savings Association.

B. Petitioners in this case are Alfred Hughes and the holding company he created for purposes of a thrift acquisition, El Paso Holding Company ("EPHC"). On August 13, 1987, Hughes personally, and acting on behalf of the holding company, entered into an Agreement and Plan of Merger and Supervisory Conversion ("Merger Agreement") to acquire El Paso Federal Savings & Loan ("El Paso Federal"), a massively insolvent Texas thrift with which Hughes had no prior involvement. Hughes obligated himself to personally capitalize EPHC, and the resulting savings and loan, by "causing" partnerships and corporations he controlled to be transferred to the institution and also by contributing cash to the supervisory merger.[3] The Agreement and infusion of these assets into the thrift institution was conditioned on approval by federal regulators and, specifically, on the government's agreement to grant a goodwill forbearance.

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[3] The partnerships and corporations that Hughes agreed to cause to be contributed into the institution controlled large holdings of real estate throughout Texas, including thousands of acres of valuable developed and undeveloped residential and commercial real estate in Austin, Texas and elsewhere. Pet. App. 104a-110a.

On August 18, 1987, EPHC filed an Application with the FHLBB to acquire El Paso Federal. Unlike many applicants, petitioners did not seek financial assistance from the government. Pet. App. 12a-13a. The acquisition depended solely upon the government's grant of a goodwill forbearance.

Over the course of the next several months, federal regulators carefully inspected each of the fourteen properties Hughes proposed to contribute to the thrift, assessed each property's net equity value, and set the properties' total market equity value at $35 million. Hughes was additionally personally obligated to purchase $11.5 million in subordinated debentures from the new institution, for a total contribution of $46.5 million. This real property and cash constituted nearly all of the assets of Hughes and his wife, as well as assets of their two children. In addition, federal regulators required Hughes personally to guarantee that certain apartment complexes which were part of the proposed contribution of real estate would generate to the thrift $10 million in net cash flow over ten years, or Hughes would have to make up the difference. Those additional obligations were memorialized in an Agreement of Obligation executed by Hughes as part of the acquisition. Pet. App. 4a.

The acquisition was approved by federal regulators on May 13, 1988. In return for Hughes causing this $35 million in property and $11.5 million in cash to be contributed to the thrift, the Board authorized the sought-after goodwill forbearance, to be amortized over a 25-year period. Pet. App. 49a, 89a. Although in some other instances the government was also required to contribute additional assets to recapitalize a thrift, the so-called "assisted

transactions," this case was *an unassisted transaction*. Hughes contributed 100% of the new capital; as the trial court found, the only consideration he or his holding company received from the government was the supervisory goodwill forbearance, with a 25-year amortization schedule. Pet. App. 128a-132a.

The new thrift, El Paso Savings Association, commenced operations on May 27, 1988, with regulatory capital of $46.5 million, of which approximately $42.5 million was supervisory goodwill. There is no dispute that Hughes satisfied all of his obligations under the agreement.

On the same day that the new financial institution opened, and two weeks after the supervisory merger was approved and the forbearance agreed to by the Board, the FSLIC required as a *pro forma* matter of regulatory policy that the holding company (but not Hughes in his individual capacity) execute a Regulatory Capital Maintenance/Dividend Agreement ("RCMDA").[4] The RCMDA required EPHC to maintain the financial institution's regulatory capital in conformance with FSLIC regulatory capital requirements. A clause of the RCMDA, *which did not appear in any other document,* stated that "All references to regulations

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[4] At the time, FSLIC policy required any shareholder holding 25% or more of the stock of a newly insured savings association to agree to maintain the association's net worth. *See* 12 C.F.R. § 571.6 (1988) (entitled "Policy considerations regarding 'de novo' applications for insurance of accounts"); *id.* § 571.6(d)(4)(i) (1988) (agreement to maintain capital tied to "granting of insurance of accounts"). EPHC was a shareholder since it owned 100% of the stock of El Paso Savings Association. Mr. Hughes was *not* a shareholder of the thrift.

of the Board or the FSLIC used in this Agreement shall include any successor regulation thereto, it being expressly understood that subsequent amendments to such regulations may be made and that such amendments may increase or decrease the Acquirer's obligations under this Agreement." Pet. App. 5a. The RCMDA also stated that it "shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns." Pet. App. 26a. Hughes was not identified as a party to the RCMDA.

One year after the recapitalized El Paso Savings Association opened its doors, Congress enacted FIRREA, which eliminated the use of supervisory goodwill. Upon the effective date of FIRREA, El Paso Savings for the first time failed its capital requirements. On September 7, 1990, a year after FIRREA eliminated El Paso Savings supervisory goodwill, the institution was placed in receivership. Petitioner Hughes lost the thrift as well as the $35 million in real estate and $11.5 million cash he had caused to be contributed, for a total loss of $46.5 million.

C. Petitioners brought this suit for breach of contract in the Court of Federal Claims, which had jurisdiction pursuant to 28 U.S.C. § 1491(a)(1). On October 23, 2003, the court granted petitioners' motion for summary judgment on liability, concluding that a contract had been entered into by the government, which the government subsequently breached. Pet. App. 16a,71a. From May 17 through July 2, 2004, the court conducted a seven-week trial ostensibly on damages, but permitted the government to re-litigate earlier decided legal issues on contract formation. On June 9, 2006, the court

issued its memorandum decision. The court reaffirmed that the FHLBB Approval Letter, Forbearance Letter, and internal government memoranda established a contract entered into by the petitioners with the government, the sole consideration for which was, from the government's side, the goodwill forbearance. The court held that the government had breached the contract and that the breach was "total, substantial and material." Pet. App. 141a.

After conclusion of the trial, but before the court issued its memorandum decision, the Federal Circuit issued two decisions that departed from traditional rules of contract interpretation and changed the analysis in *Winstar* cases. Initially in *dictum* in *Admiral Financial Corp. v. United States*, 378 F.3d 1336 (Fed. Cir. 2004), and then by a direct holding in *Franklin Federal Savings Bank v. United States*, 431 F.3d 1360 (Fed. Cir. 2005), the Federal Circuit instructed that a provision in an RCMDA, signed by a holding company, and obligating the holding company to acknowledge that subsequent amendments to regulations may be made and "that such amendments may increase or decrease the Acquiror's obligation[s] under this Agreement," 431 F.3d at 1363 (quotations omitted), put the risk of regulatory change on the private party—*even as to a specific promise of supervisory goodwill in another document*.

Bound by the Federal Circuit's rulings, the trial court held that EPHC had assumed the risk of regulatory change *when it signed the RCMDA*. However, the trial court ruled that Hughes had not personally signed the RCMDA, which was a stand-alone document that was not incorporated into the

other contract documents and was, by the government's own admission, simply a regulatory requirement applicable to El Paso's shareholder. Pet. App. 175a-177a. Therefore, the trial court held that Hughes, who was not a shareholder of El Paso Savings, was not barred by the successor-regulation provision in the RCMDA from recovering breach-of-contract damages.

D. On appeal, the Federal Circuit, observing that "we are bound by our decisions in *Admiral* and *Franklin*," Pet. App. 9a, affirmed in part and reversed in part. It dismissed the careful opinion of the trial judge who had heard seven weeks of testimony. It affirmed that EPHC had accepted the risk of regulatory change. The court, however, reversed the trial court's holding as to Hughes, concluding that although Hughes had not signed the RCMDA, he was nonetheless bound by its provisions. "Although there is *no evidence* here that the parties explicitly discussed execution of the Dividend Agreement during the merger approval negotiations," wrote the court, "that does not persuade us that the agreements in this case should be treated separately." Pet. App. 14a. (emphasis added). In admitted disregard of the facts, the court posited the new legal rule that all the documents became one agreement because:

> [1] the Approval Letter was conditioned upon compliance with all relevant regulatory provisions. [2] The relevant regulations at the time required that controlling shareholders enter into a net worth maintenance agreement, such as the Dividend Agreement, personally agreeing to maintain the institution's regulatory capital. [3] The Dividend Agreement states that it is in

> consideration for the government's approval of the merger, as set forth in the Approval Letter. [4] The Approval Letter specifically authorizes the regulators to issue the Forbearance Letter. [5] The Forbearance Letter similarly references that it is in connection with the FHLBB's approval.

Pet. App. 14a. The court rejected petitioners' argument, which had been based upon Justice Scalia's concurring opinion in *Winstar*, that since the only consideration given by the government was the goodwill forbearance, permitting the forbearance to be eliminated at the government's pleasure made the government's contractual promise illusory. Rejecting Justice Scalia's concurrence as a "minority view" of contract law, the panel observed that "this court in *Franklin* already addressed and rejected the illusory promise argument, stating that '[u]nder *Winstar*, a promise for a regulatory waiver until regulatory change occurs is plainly sufficient consideration.'" Pet. App. 10a (*quoting Franklin*, 431 F.3d at 1370); *see Franklin*, 431 F.3d at 1368 ("In our view Justice Scalia's position, far from representing the majority view, itself is a minority view on this particular issue.").

Finally, without any explanation or analysis, the court proclaimed that "regulatory approval . . . is adequate consideration." Pet. App. 10a. Therefore, notwithstanding (1) the fact that the goodwill forbearance was the only consideration provided by the government, (2) the government's undisputed breach, and (3) longstanding Federal Circuit precedent that regulatory approval is insufficient to create a contractual obligation, the court held that both Hughes and EPHC were bound by the risk of

regulatory change and could not recover the $46.5 million in cash and real estate contributed to the thrift.

REASONS FOR GRANTING THE PETITION

In this case, as in its predecessor decisions in *Admiral* and *Franklin*, the Federal Circuit treated Justice Souter's opinion for the plurality in *Winstar* as a nullity and dismissed entirely the deeply-rooted common law analysis in Justice Scalia's concurrence. The *Winstar* plurality held that the government is bound by its contracts, just as its own citizens are bound by their agreements. 518 U.S. at 895. The plurality understood that as a matter of common sense, as well as a matter of law, the acquirers of ailing thrifts—private citizens who put their own assets at risk—would never have agreed to a condition allowing the government to withdraw its sole consideration at any time, in the government's own discretion. "It would, indeed, have been madness," as Justice Souter wrote, "for respondents to have engaged in these transactions with no more protection that the Government's reading would have given them, for the very existence of their institutions would then have been in jeopardy from the moment their agreements were signed." *Id.* at 910. Justice Scalia concurred, observing that if all the government agreed to was "to regulate in this fashion for as long as we choose to regulate in this fashion," the contract would be illusory. *Id.* at 921 (Scalia, J., concurring) (quotations omitted). The Federal Circuit derided Justice Scalia's concurrence as a "minority view," and erroneously read the plurality decision in *Winstar* to sanction an agreement by the government to grant a regulatory forbearance for only so long as the government chose

to grant it. Pet. App. 10a; *see Franklin*, 431 F.3d at 1368. And it proclaimed a novel and deeply flawed legal principle that "regulatory approval is adequate consideration," although that principle cannot be reconciled with the plurality ruling in *Winstar* or with Justice Scalia's concurrence.

The Federal Circuit's reading rendered the agreement illusory and absurd. Moreover, the Federal Circuit reached its result by reading into the contract a condition that was neither foreseeable nor agreed to by petitioners—the shifting of the risk of future regulatory change to the private parties so that the sole consideration granted by the government was eliminated. The court achieved this result by regarding boilerplate language in the Board's Approval Letter that required petitioners generally to follow applicable rules and regulations as an open door through which virtually any regulatory condition could be imported into the agreement. By this tortured logic, the regulatory obligation of the holding company to enter into an RCMDA was retroactively made a term of the original acquisition agreement and applied to all parties; thereafter, it was a generic successor regulation clause in the RCMDA, signed only by EPHC, that was construed by the Federal Circuit to shift the risk of regulatory change to petitioners as to any subsequent change in regulations, including the elimination of goodwill.

This bizarre, regulatory two-step deprived petitioners of the only consideration they sought or received. Thus, while no one disputed that petitioners would not have entered into the agreement to recapitalize El Paso Federal absent the government's covenant to provide a forbearance for

supervisory goodwill, and while it also was undisputed that the signing of an RCMDA was not a subject of the parties' negotiations concerning the acquisition agreement, the court of appeals held that petitioners had unwittingly bargained away the right to enforce the one promise the government made by simply agreeing that it would comply with all rules and regulations.

This Court has repeatedly made clear that "it is this Court's prerogative alone to overrule one of its precedents." *State Oil Co. v. Khan*, 522 U.S. 3, 20 (1997). The Federal Circuit's ruling in this case ignores that requirement, effectively rendering *Winstar* a nullity. The decision is likewise openly dismissive of basic principles of contract law that this Court has steadfastly applied to contracts between the government and its citizens, blurring the lines between regulatory requirements and contracts. Moreover, the Federal Circuit decision has far-reaching ramifications, well beyond the realm of financial institutions, because any contract with the government could properly require that the private party agree to abide by all rules and regulations, and those rules could then obligate the private party to enter into ancillary agreements that deprived the party (or here its affiliates) of its bargained-for consideration. The potential impact extends to virtually any instance when the government and a private party enter into a commercial agreement. Certiorari should therefore be granted. The Court may wish to consider summary reversal of the court of appeals' judgment.

I. THE FEDERAL CIRCUIT DECISION MARGINALIZED *WINSTAR* AND APPLIED ERRANT PRINCIPLES OF CONTRACT LAW INCOMPATIBLE WITH THIS COURT'S RULINGS.

It is not surprising that the decision of the court of appeals in this case cites *Winstar* only in passing, when discussing the historical role of goodwill forbearances. Instead, the ruling of the court of appeals rests on two Federal Circuit cases, *Admiral* and *Franklin*. In those two cases, as in the decision below, the Federal Circuit misread *Winstar*, and developed an alternative and wayward jurisprudence.

A. Justice Scalia's concurrence in *Winstar*, joined by Justices Thomas and Kennedy, observed that if the government's arguments that it should not be liable for its own breach were credited, the contracts at issue, involving promises of goodwill forbearances, would be rendered unenforceable because the government's consideration would be illusory. Justice Scalia wrote as follows:

> [Respondents'] claim is that the Government quite plainly *promised* to regulate them in a particular fashion, into the future. They say that the very *subject matter* of these agreements, an essential part of the *quid pro quo*, was Government regulation; unless the Government is bound *as to that regulation*, an aspect of the transactions that reasonably must be viewed as a *sine qua non* of their assent becomes illusory. I think they are correct. If, as the dissent believes, the Government committed only 'to provide [certain] treatment unless and until there is subsequent action' then the Government in effect said 'we promise to regulate in this fashion for as

> long as we choose to regulate in this fashion'—which is an absolutely classic description of an illusory promise.

518 U.S. at 921 (citation omitted) (emphases in original). No one can fairly deny this basic common law principle—whether stated in a plurality or concurring opinion. Yet the Federal Circuit in *Franklin* rejected Justice Scalia's reading of the common law. "Franklin," wrote the Federal Circuit, "urges that we treat Justice Scalia's opinion as binding and hold that a contract for temporary regulatory forbearance is illusory." 431 F.3d at 1367. "In our view Justice Scalia's position, far from representing the majority view, itself is a minority view on this particular issue." *Id.* at 1368. The Federal Circuit went even further, and without benefit of authority proclaimed that "[u]nder *Winstar*, a promise for a regulatory waiver until regulatory change occurs, is plainly sufficient consideration." *See id.* at 1370. The panel below felt compelled to follow its prior decision in *Franklin* and thus rejected Justice Scalia's analysis.

The Federal Circuit's surprising departure from basic contract law, apparently because it was recited in a concurring opinion, was obvious error. It is well-established that "[w]here a promisor retains an unlimited right to decide later the nature or extent of his performance, the promise is too indefinite for legal enforcement. The unlimited choice in effect destroys the promise and makes it merely illusory." 1 Richard A. Lord, *Williston on Contracts* § 43 (4th ed. 1990). *See* 2 Arthur Linton Corbin, *Corbin on Contracts* § 5.28 (1995 ed.) (when "A's words leave A's future action subject to A's own future whim," it constitutes an illusory promise); Restatement

(Second) of Contracts § 2 cmt. e (1981) ("Words of promise which by their terms make performance entirely optional with the 'promisor' whatever may happen, or whatever course of conduct in other respects he may pursue, do not constitute a promise."); *id.* § 77 cmt. a (*Illusory promises*. Words of promise which by their terms make performance entirely optional with the 'promisor' do not constitute a promise."). *See also* E. Allen Farnsworth, *Farnsworth on Contracts* § 2.13 at 133 (3d ed. 2004) (statement "I will *if* I want to" is an illusory promise).[5] No contract jurisprudence—in the Federal Circuit or elsewhere—suggests that different rules should apply to the government.

Indeed, this Court has repeatedly rejected constructions that would render government contracts illusory. *See, e.g., Cherokee Nation of Okla. & Shoshone-Paiute Tribes of the Duck Valley Reservation v. Leavitt,* 543 U.S. 631 (2005) (rejecting construction of a statute that would have made contract illusory by permitting government to refuse to pay full amount promised by contracts, and rejecting argument that Indian tribes should bear the risk that congressional appropriations would be insufficient to meet costs); *Franconia Assocs. v. United States*, 536 U.S. 129, 142 (2002) (rejecting Federal Circuit's interpretation of contracts

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[5] As Justice Holmes observed in *The Common Law*, "[A] promise to pay for clothes if made to the customer's satisfaction, has been held in Massachusetts to make the promisor his own final judge. So interpreted, it appears to me to be no contract at all . . . . His promise is only to pay if he sees fit, and such a promise cannot be made a contract because it cannot impose any obligation." Oliver Wendell Holmes, *The Common Law* 247 (Mark De Wolf Howe ed., Belknap Press: 1963 (1881)).

established by statutory scheme when that interpretation would make the government's obligation "meaningless" and would result in a contract that was illusory); *City of Detroit v. Detroit Citizens' St. Ry.*, 184 U.S. 368, 384 (1902) (rejecting as "hardly . . . credible" the city's suggestion that the fare rate agreed on with railroad company, which "amounted to a contract," would be "subject to change from time to time" at the city's pleasure); *Murray v. City of Charleston*, 96 U.S. 432, 445 (1877) (government contract should be viewed as "an assurance that [a sovereign right to withhold payment] will not be exercised. A promise to pay, with a reserved right to deny or change the effect of the promise, is an absurdity.").

The goodwill forbearance at issue in this case was the *only consideration* contributed by the government, as testified to by the government's own regulator-witnesses who negotiated this contract, and as found by the trial court. James Satterfield, the most senior regulator involved in negotiating the transaction, testified that other than the forbearance granted in connection with the application, he was not aware of any other obligation that the United States government was contractually required to perform in connection with the acquisition. Pet. App. 129a-131a. (Q: "And other than the forbearance granted in connection with the application, you're not aware of any other obligation that the United States government was contractually required to perform in connection with the acquisition, isn't that correct?" A: "Not in connection with the acquisition, no."). Janet Hovey, the regulator most involved in the transaction, testified similarly. Pet. App. 131a. It was uncontroverted that, absent the goodwill forbearance, El Paso Savings would not have even

been allowed to open its doors for business. The trial court thus found *as a fact* that "absent the goodwill forbearance, all plaintiffs received was a multi-million dollar debt that was not bargained-for and was not worth a peppercorn." Pet. App.131-132a.[6] Under the well-established law referred to by Justice Scalia in his concurrence, the Federal Circuit's ruling resulted in a contract construction that, by eliminating the goodwill forbearance, rendered the government's consideration illusory.

B. The Federal Circuit decision is equally impossible to reconcile with the plurality opinion in *Winstar*. The Federal Circuit attempted to support its position by remarking that "[u]nder *Winstar* a promise for a regulatory waiver until regulatory change occurs, is plainly sufficient consideration." Pet. App. 10a; *see Franklin*, 431 F.3d at 1370. But that astonishing ruling not only turns the common-law rule on its head, it also defies the plurality opinion in *Winstar*. The *Winstar* plurality recognized the absurdity of construing a contract to require a party to assume the risk of regulatory change when, without the goodwill forbearance, the acquired thrift would immediately fail (or, as here, never would have been allowed to open its doors in the first place):

> [I]t would have been irrational in this case for [the thrift] to stake its very existence upon [the] continuation of current policies without seeking to embody those policies in some sort of contractual commitment. This conclusion is obvious from both the dollar amounts at stake and the regulators' proven propensity to make

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[6] The Federal Circuit's ruling did not disturb this determination.

> changes in the relevant requirements. . . . Under the circumstances, we have no doubt that the parties intended to settle regulatory treatment of these transactions as a condition of their agreement.

Id. at 863-64 (citations omitted). As Justice Souter observed, going to the heart of the matter, "[i]t would, indeed, have been madness for respondents to have engaged in these transactions with no more protection than the Government's reading would have given them, for the very existence of their institutions would have been in jeopardy from the moment their agreements were signed." *Id.* at 910. Yet the Federal Circuit here construed and approved agreements to embody *precisely* that "madness." A more obvious broadside attack on *Winstar* is hard to imagine.

C. The Federal Circuit's notion that "regulatory approval" is adequate consideration likewise fails. The Federal Circuit's one-line conclusion that regulatory approval is sufficient consideration is equally absurd. Precisely the same argument could have been made in *Winstar*. Yet Justice Scalia's concurrence posited that notwithstanding governmental approval, and indeed notwithstanding the regulator's infusion of money through an assistance agreement, the government's interpretation of the contracts at issue constituted an "absolutely classic description of an illusory promise." 518 U.S. at 921. Regulatory approval is hardly valuable consideration where it is an approval for a private party to put his family fortune at risk with no guarantee that the government would not change the rules and immediately wipe out that investment on as little as a regulatory whim. Here, the "regulatory

approval" allowed Mr. Hughes to give $46.5 million of his family's assets to pay what were otherwise *the government's liabilities* to El Paso Federal's prior depositors and acquire "a multi-million dollar debt that was not bargained-for and was not worth a peppercorn." Pet. App. 131a-132a.

Shortly after *Winstar*, the Federal Circuit correctly understood that the mere approval of a supervisory merger by banking agencies was not consideration at all and did not create contractual obligations. *See D&N Bank v. United States*, 331 F.3d 1374, 1378-79 (Fed. Cir. 2003); *Fifth Third Bank of W. Ohio v. United States*, 402 F.3d 1221, 1234 (Fed. Cir. 2005). In *D&N Bank*, the Federal Circuit opined that "something more" than mere regulatory approval was necessary to support a finding that the government accepted an offer and entered into a binding agreement. 331 F.3d at 1379. In *Anderson v. United States*, 344 F.3d 1343, 1356 (Fed. Cir. 2003), the Federal Circuit explained that the something more consisted of "a manifest assent to the same bargain proposed by the offer." 344 F.3d at 1356 (*quoting* Restatement (Second) of Contracts § 50 cmt. a).[7] Regulatory approval by itself, therefore, is not consideration sufficient to sustain a contract. To hold otherwise would violate principles of contract formation as well as the Tucker Act's prohibition of

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[7] The government, for its part, has strenuously and consistently argued, for example, that regulatory approval standing alone cannot constitute consideration that binds the government to a contract. The government's opening brief on appeal in this case made the point clearly. Pet. App. 178a (Gov't Br. at 14 & n.2. ("This Court should not find a contract based upon documents that consist of nothing more than regulatory approvals.").

implied-in-law contracts. *See Hatzlachh Supply Co. v. United States*, 444 U.S. 460, 465 n.5 (1980) (per curiam) ("[T]he Court of Claims' jurisdiction with respect to contracts extends only to actual contracts, either express or implied in fact; it does not reach claims on contracts implied in law."); *United States v. Algoma Lumber Co.*, 305 U.S. 415, 418 (1939). Here, as the government's chief regulators and negotiators testified at trial, and as the trial court found, the only consideration was the goodwill forbearance that was eliminated by FIRREA.

II. THE COURT OF APPEALS' RELIANCE ON GENERAL LANGUAGE IN THE APPROVAL LETTER TO PLACE RETROACTIVELY NEW OBLIGATIONS ON PETITIONERS CREATES A RULE OF CONTRACT INTERPRETATION RIFE WITH IRRATIONALITY AND UNFAIRNESS.

A. The essence of a contract is that the parties reached an agreement whose terms are sufficiently definite to be enforced. The requirement of definiteness "is implicit in the premise that contract law protects the promisee's expectation interest." E. Allen Farnsworth, *Farnsworth on Contracts* § 3.1 (3d ed. 2004). In this case, petitioners expected that the government would provide a goodwill forbearance amortized over a 25-year period, and expected that if the government breached that agreement, damages would be the proper remedy.

Yet in an unsupportable reading of the underlying agreement, the Federal Circuit upset all reasonable expectations of petitioners. The court construed a provision in the Approval Letter requiring

petitioners' compliance with all applicable regulations as an open door through which virtually any regulatory requirement could be added to an already finalized agreement and trump its core provisions. The Federal Circuit cited no case law for its proposition that general language referencing compliance with rules and regulations could be used to include as a contract obligation a regulatory requirement never discussed during contract negotiations which eliminated the government's obligation to provide the contracted-for consideration. Yet if the Federal Circuit's reading were to be generally adopted, and it is now the law that presumably must be applied by both the Federal Circuit and the Court of Federal Claims, it would give the government license to alter the terms of contracts it entered into, and thereby insulate itself from damages, by the simple expedient of importing into the contract one or more regulatory requirements imposed on one of the parties but never made the basis of the bargain, including regulatory requirements promulgated after the contract was entered into.

B. Compounding the error, the Federal Circuit construed the contract to bind Hughes, even though the RCMDA was executed only by the holding company, was not signed by Hughes in his personal capacity, was never discussed in connection with the acquisition, and lacked any provision linking it with other documents. The trial court found, after weeks of testimony on contract formation, that Hughes was not a party to the RCMDA and that the RCMDA did not bind him. Pet. App. 176a-177a. Even the Federal Circuit itself recognized that "there is no evidence here that the parties explicitly discussed execution of the Dividend Agreement during the merger approval

negotiations." Pet. App. 14a. Accordingly, if the regulatory provision was applicable at all, it was applicable only to the holding company, since by reason of FSLIC "policy," only the holding company was obliged to execute the agreement.[8]

As a matter of common sense, the court of appeals' conclusion that Hughes agreed that the government could renege on its promise of a 25-year forbearance *and* accepted the risk of regulatory change by virtue of the all-regulations clause cannot be credited. No sane person would have agreed to forfeit both the consideration he bargained for and a legal remedy against the government for breach, when his financial well-being and that of his wife and children were at stake. That would have been "madness," as the *Winstar* plurality recognized.

C. The Federal Circuit's through-the-looking-glass reasoning does not merely deprive petitioners of the

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[8] The execution of some form of net worth maintenance obligation was a matter of FSLIC *policy*. 12 C.F.R. § 571 (1989) was styled "Policy considerations regarding 'de novo' applications for insurance of accounts." This section advised that "[t]he Corporation deems it advisable that de novo applicants for insurance of accounts, including applicants for permission to organize a federal association (federal charter) be informed *of certain policies* governing applicable review which the Corporation has adopted." (Emphasis added). *See id.* § 571.6(d)(4)(i) (1989) (requiring, as a matter of policy, that controlling shareholders agree to maintain the institution's regulatory capital at the required level and to execute an agreement with the Corporation stating this). As the Court noted in *Winstar*, the regulatory capital requirements applied only to thrifts that chose federal insurance, and not to thrifts that either chose to self-insure or to seek private insurance elsewhere. 518 U.S. at 894, n.37 (plurality decision) (*citing* Federal Home Loan Bank System, *A Guide to the Federal Home Loan Bank System* 69 (5th ed. 1987)).

only consideration the government had provided and inflict a staggering financial loss on Hughes and his family. It also will harm the government and leave it poorer in the long term.

The government, in exceptional circumstances, finds it necessary to ask private parties to step in and, through contract, personally shoulder public financial obligations subject to certain governmental guarantees or promises. The thrift crisis of the 1980s was one such occasion. In the 1980s, the government attempted to save failing thrifts, and avoid paying their federally insured depositors, by encouraging private citizens to invest their own resources and promising to regulate in a certain manner to give the private parties a reasonable opportunity to make the thrifts successful. *Winstar* upheld the right of the citizen to expect its government to honor its promises, or be liable in breach—the very obligation that any citizen has when he or she enters into a contract. The willingness of citizens to enter into commercial agreements with the government will be eroded by decisions such as this, where the court of appeals fashioned new rules designed to benefit the government.

III. THE FEDERAL CIRCUIT ERRED IN ITS READING OF THE SUCCESSOR REGULATION CLAUSE, A READING AT ODDS WITH *WINSTAR* AND RULINGS OF THE COURT OF FEDERAL CLAIMS THAT FAITHFULLY APPLIED *WINSTAR*.

A. In the Federal Circuit's *en banc* decision in *Winstar Corp. v. United States*, the court reasoned that while the capital maintenance agreement in that case "required Winstar to abide by any changes in the

law regarding regulatory capital," that language merely:

> requires Winstar to maintain its capital at levels set by the bank regulators. Winstar, like other thrifts, was bound to keep in compliance with banking regulations and laws regarding capital levels except to the extent the Bank Board expressly agreed to forbear from enforcing its regulations against it. This stipulation by Winstar to maintain its regulatory net worth at whatever levels the regulators set *does not, however, eclipse the government's own promise that Winstar could count supervisory goodwill in meeting the regulatory requirements with which it had promised to comply.*

64 F.3d 1531, 1544 (Fed. Cir. 1995) (emphasis added), *aff'd*, 518 U.S. 839 (1996).

However, in this case, and in its rulings in *Admiral* and *Franklin*, the Federal Circuit gave the successor-regulation clause precisely the opposite construction. Rather than saving the contract, the Federal Circuit destroyed it and left the entire benefit in the government's hands. The court of appeals thus failed to follow the most fundamental rule of contract interpretation—that "interpretations which render the contract fair and reasonable are preferred to those which render the contract harsh or unreasonable to one party." *See* 11 Richard A. Lord, *Williston on Contracts* § 32:11 (4th ed. 1990). Application of this rule is particularly important where one of two or more interpretations would undo a government promise. *Cf. Cherokee Nation of Oklahoma v. Leavitt*, 543 U.S. 631, 646 (noting, in construing a statute, that although "[o]n the basis of language alone we would find either interpretation

reasonable," nonetheless "[t]he first interpretation would undo a binding governmental promise," and must be rejected); *Torncello v. United States*, 681 F.2d 756, 771 (Ct. Cl. 1982) ("[W]e will not construe a contract clause in such a way that the contract is destroyed if there is an alternate reading that will uphold the contract.").[9]

B. The Federal Circuit's misapplication of ordinary principles of contract law is particularly troubling given how its reasoning with respect to the meaning of the successor-regulation clause evolved. Prior to its ruling in *Admiral*, the Federal Circuit appeared to concur with the numerous rulings of the Court of Federal Claims holding that the clause did not shift the risk of regulatory change with respect to the grant of a goodwill forbearance but applied, if at all, to regulations governing capital maintenance. For example, in *Castle v. United States*, the Court of Federal Claims observed as follows:

> Defendant would have the court accept an interpretation whereby a very specific provision of the agreement setting forth the unique means

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[9] The Federal Circuit, moreover, imposed its unfair and unwarranted gloss on the successor-regulation clause even though, in a long line of earlier decisions, the Court of Federal Claims had rejected this reading. The Court of Federal Claims reasonably concluded that the successor regulation language, appearing only in a regulatory capital maintenance agreement, governed regulations pertaining only to levels of regulatory capital and did not extend to regulations governing supervisory goodwill. *See Admiral Financial Corp. v. United States*, 54 Fed. Cl. 247, 256-57 (2002); *Hometown Financial, Inc. v. United States*, 53 Fed. Cl. 326, 336-337 (2002); *Castle v. United States*, 42 Fed. Cl. 859, 863-64 (1999), *aff'd in part and rev'd in part on other grounds*, 301 F.3d 1328 (Fed. Cir. 2002); *California Federal Bank v. United States*, 39 Fed. Cl. 753, 769-70 (1997).

> by which the thrift may meet its capital standards, and designed to induce capital investment in the thrift and to permit the thrift the flexibility in the near term to turn the fortunes of Western Empire around, could be destroyed at any time for any reason. It is unreasonable to believe that anyone . . . would agree to a provision that would enable its contracting partner to vitiate the essence of the deal at any time.

42 Fed. Cl. at 863-64. In *Admiral*, that changed, but the issue of the successor regulation clause was addressed only in *dictum*; the Federal Circuit had already held that plaintiff did not suffer damages as a result of the government's breach of contract. It nonetheless addressed the government's alternative argument and opined that the risk-shifting provision in the RCMDA, which would not have affected the outcome in that case, put the risk of regulatory change on the plaintiffs.

Thereafter in *Franklin,* the Federal Circuit treated the *Admiral dictum* as a holding, signaling an unabashed departure from mainstream contract law jurisprudence. The *Admiral* court, recognizing that its interpretation might otherwise render the contract illusory, had explained that its holding was premised on the fact that the government in that case had provided other consideration in addition to the goodwill forbearance. 378 F.3d at 1341. The *Franklin* court, however, dealt with a different situation, one where the goodwill forbearance at issue was *the only consideration* the government had provided. It nonetheless ruled that the private citizen had accepted the risk of regulatory change, even though that eliminated the only consideration

provided by the government. Thus, by slow accretion over a series of cases, the Federal Circuit managed to eviscerate this Court's decision in *Winstar*.

The plurality in *Winstar* clearly recognized that "the Bank Board and the FSLIC were contractually bound to recognize the supervisory goodwill and the amortization periods reflected in the agreements between the parties," and the Court firmly stated that "[w]e read this promise as the law of contracts has always treated promises to provide something beyond the promisor's absolute control, that is, as a promise to insure the promisee against loss arising from the promised condition's nonoccurrence." 518 U.S. at 868. When, in *Franklin*, the court for the first time squarely permitted the government to grant consideration for a contract subject to the government's own unilateral revocation in the future, it deviated from both established contract principles and the Court's ruling in *Winstar*.[10] Judge Rader properly observed in his dissent in *Franklin* that "[t]he court today goes too far in its reliance on *Admiral*," and he correctly concluded that "the contract between the Government and Franklin did not shift the risk of regulatory changes to Franklin." 431 F.3d at 1372 (Rader, J., dissenting). Accordingly, far from applying *Winstar*, the Federal Circuit has undermined this Court's ruling. In order to protect

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[10] While the plurality suggested in a footnote that clearer language might have resolved the problem before the Court, and cited to an Eleventh Circuit case, *Guaranty Fin. Serv., Inc. v. Ryan*, 928 F.2d 994, 999-1000 (11th Cir. 1991), the Court did not address what language qualified as clear, or whether clear language could shift the risk of regulatory change to a private party when the result eliminated the only consideration provided by the government.

the government, the court has imposed a huge cost on the very citizens who at the government's behest invested in failing thrifts.

IV. CERTIORARI IS WARRANTED TO CORRECT THE COURT OF APPEALS' ERRORS.

A. The Decision Of The Court Of Appeals Reflects An Increasing Departure From Mainstream Contract Jurisprudence.

This Court has instructed that "[w]hen the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals." *Lynch v. United States*, 292 U.S. 571, 579 (1934); *Winstar*, 518 U.S. at 895. If the government repudiates its obligations, "it is as much repudiation, with all the wrong and reproach that term implies, as it would be if the repudiator had been a State or a municipality or a citizen." *Winstar*, 518 U.S. at 912 (Breyer, J., concurring) (*quoting Sinking-Fund Cases*, 99 U.S. 700, 719 (1878)). As Justice Souter framed the rule in *Winstar*, "when the United States 'comes down from its position of sovereignty, and enters the domain of commerce, it submits itself to the same laws that govern individuals there." 518 U.S. at 895 n.39 (opinion of Souter, J., joined by Stevens, O'Connor, & Breyer, JJ.) (quoting *Cooke v. United States*, 91 U.S. 389, 398 (1875)). If the government departs from these rules, it will adversely impact the government's "own long-run interest as a reliable contracting partner in the myriad workaday transactions of its agencies." *Id.* at 883.

This Court must look to the Federal Circuit to implement these rules because of the Federal Circuit's plenary jurisdiction over federal contract litigation. Where, as here, the Federal Circuit has plainly declined its role, this Court must grant review to set the law straight. The decision below was not only preceded by equally erroneous rulings in *Admiral* and *Franklin*; it follows an increasing tendency of that Circuit to issue decisions that run counter to the ruling in *Winstar* and that misapply the rules of contract law to the short-term benefit the government. This has occurred not only in cases involving issues of contract consideration, but cases involving contract remedies and formation. *See, e.g.*, *Glendale Fed. Bank, FSB v. United States*, 239 F.3d 1374 (Fed. Cir. 2001) (reversing award of restitution damages notwithstanding undisputed evidence that the government benefited from the transaction); *Castle v. United States*, 301 F.3d 1328 (Fed. Cir. 2002) (denying claims for restitution), *cert. denied*, 539 U.S. 925 (2003); *Bluebonnet Sav. Bank, F.S.B. v. United States*, 339 F.3d 1341 (Fed. Cir. 2003) (vacating trial court's award of damages). It is not surprising, as one observer has noted, that "[e]ight years after [the] high court said Uncle Sam was on the hook over [the] thrift crisis, few plaintiffs have even seen a penny." *The S&L Payouts that Never Came*, Legal Times (Feb. 16, 2004). While "[i]t is this Court's prerogative alone to overrule one of its precedents," *State Oil Co. v. Khan*, 522 U.S. 3, 20 (1997); *Rodriguez de Quijas v. Shearson American Express, Inc.*, 490 U.S. 474, 484 (1989), the Federal Circuit has, by small bites, eclipsed *Winstar*.

This Court has frequently granted review in cases that arise under the Federal Circuit's exclusive jurisdiction over breach of contract claims,

recognizing the overwhelming importance of that court's decisions. *See, e.g., Mobil Oil Exploration & Producing Southeast, Inc. v. United States*, 530 U.S. 604 (2000); *Winstar*, *supra*; *Hercules, Inc. v. United States*, 516 U.S. 417 (1996); *Keene Corp. v. United States*, 508 U.S. 200, (1993); *see also* Stern & Gressman, *Supreme Court Practice* § 4.21 at 264-65 (8th ed. 2002) ("The issues arising in this type of litigation [before the Federal Circuit] involving many of the legal obligations of the United States, can have a special importance that warrants review by the Supreme Court.").

B. The Effect Of The Federal Circuit Rulings Extends Well Beyond *Winstar*.

The published decision of the Federal Circuit in this case presents the issues in clear form, without alternative holdings, and is an appropriate vehicle to review the Federal Circuit's jurisprudence. While this case is a "*Winstar* case," the principles of law now being misapplied by the Federal Circuit are applicable in virtually any contract case that comes before that court.

The government frequently enters into contracts with private parties in order to "further its regulatory goals through contract." *Winstar*, 518 U.S. at 886. These contracts range, for example, from construction and commercial purchasing agreements to agreements governing off-shore oil exploration, storage of spent nuclear fuel, and implementation of the Endangered Species Act. If these contracts prompt litigation, the cases are often heard by the Federal Circuit which, pursuant to 28 U.S.C. § 1295, has jurisdiction over appeals from the Court of Federal

Claims involving express or implied contracts with the United States.

It is plain that under the contract rules applied by the Federal Circuit, the government, which always has immense bargaining power *vis-a-vis* private parties, will have that power enhanced whenever there is an opportunity to shift the risk of regulatory change to the private party, even if that renders the sole consideration for the contract a nullity. Indeed, what citizen could explain a refusal to sign a provision requiring compliance with rules and regulations? And who could imagine that, in doing so, he or she would be deprived of *all* of the benefits that they had bargained and paid dearly for? The inevitable impact of these decisions, unless corrected, will be to put private parties at an even greater disadvantage when negotiating with the government, dissuade many private parties from contracting with the government and, with fewer potential bidders, make contracting more expensive for the government, to the detriment of the public fisc.

As the plurality rightly observed in *Winstar*, expanding the government's ability to avoid its contractual obligations "undermin[es] the Government's credibility at the bargaining table and increase[es] the cost of its engagements." *Winstar*, *id.* at 884; *see also Lynch v. United States*, 292 U.S. 571, 580 (1934) (Brandeis, J.) ("Punctilious fulfillment of contractual obligations is essential to the maintenance of the credit of public as well as private debtors."). The result is that the government would undermine its "own long-run interest as a reliable contracting partner in the myriad workaday transaction of its agencies." *Winstar*, 518 U.S. at 883; *see also id.* at 913 (Breyer, J., concurring) (limiting ability of the

government to avoid its contractual obligations because "in practical terms it ensures that the government is able to obtain needed goods and services from parties who might otherwise, quite rightly, be unwilling to undertake the risk of government contracting.").

CONCLUSION

The petition for a writ of certiorari should be granted. The Court may wish to consider summary reversal of the court of appeals' judgment and reinstatement of the well-reasoned decision of the trial court.

Respectfully submitted,

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APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

Nos. 2006-5112, 2006-5118.

ALFRED D. HUGHES,
Plaintiff-Appellee,

and

EL PASO HOLDING CORPORATION,
Plaintiff-Cross Appellant,

v.

UNITED STATES,
Defendant-Appellant

DECIDED: August 29, 2007

Before MAYER, RADER, and MOORE, Circuit Judges.

MOORE, Circuit Judge.

The United States appeals three holdings in two decisions of the Court of Federal Claims in this *Winstar* breach of contract case. *Hughes v. United States*, 58 Fed.Cl. 291 (2003) (*Hughes I*); *Hughes v. United States*, 71 Fed.Cl. 284, 287 (2006) (*Hughes II*). First, the government challenges the court's conclusion that an individual corporate officer,

Alfred Hughes (Hughes), had standing to sue for breach of contract. Second, the government challenges the court's conclusion that Hughes did not assume the risk of regulatory change resulting from the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Pub.L. No. 101-73, 103 Stat. 183. Third, the government challenges the amount and propriety of damages awarded to Hughes. Appellee El Paso Holding Corporation (EPHC) cross-appeals the Court of Federal Claims' holding that EPHC assumed the risk of regulatory change and therefore could not recover for the government's alleged breach of its contract with EPHC.

We conclude that there was only one overall contractual agreement with the government in this case, and that agreement shifted the risk of regulatory change to the private parties. We therefore affirm the Court of Federal Claims' holding that the government was not liable to EPHC for its breach of the agreement by enacting FIRREA. To the extent that Hughes was a party to the agreement, he too assumed the risk of regulatory change. We therefore reverse the court's judgment finding the government liable to Hughes and awarding Hughes damages based on that liability.

BACKGROUND

El Paso Federal Savings and Loan Association (Old El Paso) was a Federal mutual savings association or "thrift." In the mid 1980's, Old El Paso "was one of many thrifts that became undercapitalized when `the combination of high interest rates and inflation in the late 1970's and

early 1980's brought about a ... crisis in the thrift industry.'" *Franklin .Fed. Sav. Bank v. United States*, 431 F.3d 1360, 1361 (Fed.Cir.2005) (citing *United States v. Winstar*, 518 U.S. 839, 845, 116 S.Ct. 2432, 135 L.Ed.2d 964 (1996)), Hughes entered into an Agreement and Plan of Merger and Supervisory Conversion (Merger Agreement) with Old El Paso, pursuant to which Old El Paso would be merged into El Paso Savings Association (New El Paso). The resulting thrift would be a wholly-owned subsidiary of EPHC. *Hughes II*, 71 Fed.Cl. at 287. Hughes created EPHC to hold New El Paso's stock, and Hughes became EPHC's president and majority shareholder. The Merger Agreement contemplated that Hughes and EPHC would acquire Old El Paso in exchange for 14 real estate parcels valued at $47.3 million and $11.5 million cash. *Id.* at 287. The Merger Agreement had several conditions precedent, notably, the "[a]mortization of goodwill arising from purchase method accounting, for regulatory purposes, by use of the straight-line method over a 25-year period." *Id.*

On August 18, 1987, EPHC filed the Merger Agreement as part of an Application for approval of the merger with the Federal Home Loan Bank Board (FHLBB). *Id.* at 288. The Application, which was signed by Hughes as President of EPHC, detailed that Hughes would cause the fourteen real estate parcels to be contributed to the capitalization of the merged company. *Id.* During the review and negotiation process, the FHLBB agents focused on the value of the proposed contribution of these real estate parcels. *Id.* at 299-301. Hughes was heavily involved with the agents' investigation, providing them with necessary information relating to

ownership and valuation. *Id.* at 300. The FHLBB was particularly concerned that twelve of the fourteen parcels were low-income housing apartments. *Id.* at 301. To ease this concern, the head FHLBB agent made Hughes agree: (1) to personally guarantee that a yearly rental income of $1 million for these properties would flow to the thrift; (2) that Hughes would continue to manage the properties; and (3) that the properties would not be sold for less than book value without regulatory consent. *Id.* at 301. With these guarantees in place, the parties agreed on a $35 million valuation of the real estate contribution. These guarantees were subsequently reduced to writing in an Agreement of Obligation.

On May 13, 1988, the FHLBB issued an Approval Letter to the Boards of Directors for EPHC and Old El Paso. The Approval Letter notified the companies of FHLBB's approval of Old El Paso's conversion from a mutual savings and loan to a stock-chartered thrift as well as EPHC's Application to acquire control of the thrift. On the same day, FHLBB also issued a Forbearance Letter, addressed to the President of Old El Paso, granting the merged entity certain supervisory forbearances. *Id.* at 289-90. Most notably, the Forbearance Letter included a goodwill accounting forbearance permitting "the value of any unidentifiable intangible assets resulting from accounting for the merger in accordance with the purchase method [to be] amortized by New El Paso over a period not to exceed twenty five (25) years."

On the closing date for the merger, May 27, 1988, Hughes personally signed the Agreement of Obligation as Obligor, and he signed on behalf of

New El Paso as Obligee. The FHLBB also signed the Agreement of Obligation, but its role was specifically limited to the right to enforce the obligations *on* behalf of New El Paso.

On the same day, EPHC and the Federal Savings and Loan Insurance Corporation (FSLIC) executed a Regulatory Capital Maintenance Dividend Agreement (Dividend Agreement). The Dividend Agreement provided that "in consideration of the FSLIC approving the acquisition of control of El Paso Federal ... [EPHC] will cause the Regulatory Capital of [New El Paso] to be maintained at a level at or above the Regulatory Capital Requirement and as necessary, will infuse sufficient additional capital ... to effect compliance with such requirement." According to the Dividend Agreement's definitions, "'Regulatory Capital Requirement' means the Resulting Institution's regulatory capital requirement at a given time computed in accordance with 12 C.F.R. § 563.13(b), or any successor regulation thereto." The Dividend Agreement also included a Miscellaneous Provision that stated "[a]ll references to regulations of the Board or the FSLIC used in this Agreement shall include any successor regulation thereto, it being expressly understood that subsequent amendments to such regulations may be made and that such amendments may increase or decrease the Acquiror's obligation under this Agreement."

After the closing, Old El Paso converted from a mutual to stock-form of ownership and EPHC acquired Old El Paso and merged the thrift into New El Paso. In addition, Hughes caused the real estate parcels and cash capitalization to occur, although

not precisely as contemplated in the Application.[1] Regulators reviewing the transaction agreed that it was "complete and acceptable" in accordance with the requirements in FHLBB's Approval Letter.

Just over a year after the El Paso conversion and merger transaction, Congress enacted FIRREA, which limited the ability of thrift institutions to count supervisory goodwill towards their regulatory capital requirements. *See Winstar*, 518 U.S. at 856-60, 116 S.Ct. 2432. Under these new capital standards, New El Paso's regulatory capital fell below the required levels. *Hughes II*, 71 Fed.Cl. at 291. Regulators informed New El Paso that it would be out of capital compliance on December 7, 1989 (the effective date of the FIRREA-implementing regulations). Id. New El Paso was directed "to *immediately* discontinue including supervisory

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[1] According to the Application, EPHC was to obtain the fourteen real estate parcels from their owners, and EPHC was to contribute the parcels to Old El Paso in exchange for stock. Instead, the owners of thirteen of the parcels passed the real estate directly to Old El Paso in exchange for stock. The final parcel, which constituted half of Tract B of the Steiner Ranch, was sold by Mr. Steiner to Old El Paso for $11.5 million. Also according to the application, $10 million of the $11.5 million cash capitalization, was originally to come from an unrelated company, PasoTex. However, when Hughes uncovered illegal conduct by officials for that company, he amended the proposal for a cash contribution, proposing Mr. Steiner would purchase $10 million in Series A stock. After the application was approved, Hughes sought and received regulatory approval to purchase the stock in his own name, rather than having Mr. Steiner purchase it, in order to avoid potentially adverse tax treatment. Hughes funded this purchase by borrowing money from Mr. Steiner.

goodwill" in its capital calculation. *Id.* at 291-92. On September 7, 1990, New El Paso remained far below the capital requirements, and the Office of Thrift Supervision placed New El Paso in a receivership with significant operating restrictions. New El Paso was subsequently liquidated. *Id.* at 292.

Hughes and EPHC filed a complaint in the Court of Federal Claims on September 5, 1990, alleging that the government's enactment of FIRREA constituted a breach of contract between the plaintiffs and the government, which allowed New El Paso to count goodwill toward its regulatory capital requirements. After the Supreme Court's 1996 decision in *Winstar*, the Court of Federal Claims originally granted both plaintiffs' motions for summary judgment as to liability. *Hughes I*, 58 Fed.Cl. at 313. The court thereafter conducted a trial on damages and reconsidered its earlier decision as to liability based upon two intervening decisions from this court: *Admiral Financial Corp. v. United States*, 378 F.3d 1336 (Fed.Cir.2004), and *Franklin Federal Savings Bank v. United States*, 431 F.3d 1360 (Fed.Cir.2005). In *Hughes II*, the court determined based on our precedent that the government was not liable to EPHC because EPHC assumed the risk of regulatory change in the Dividend Agreement. 71 Fed.Cl. at 292-93. The court held, however, that Hughes was not bound by the Dividend Agreement, and therefore, did not assume the risk of regulatory change. *Id.* at 324. The Court of Federal Claims awarded Hughes $46.5 million in damages for the value of real estate and cash that he caused to be contributed to the thrift.

This appeal followed. We have jurisdiction

pursuant to 28 U.S.C. § 1295(a)(3).

DISCUSSION

I.

The first issue for this court to address is whether EPHC. assumed the risk of regulatory change. The Court of Federal Claims determined that "[u]nder binding Federal Circuit precedent, [EPHC] agreed to bear the risk that regulatory capital requirements could change both in amount and in constituent components." *Hughes II*, 71 Fed.Cl. at 321. Whether parties to a contract agreed to put the risk of regulatory change squarely on one party is a question of law that we review *de novo*. *Hometown Fin., Inc. v. United States*, 409 F.3d 1360, 1366 (Fed.Cir.2005).

In *Admiral*, the parties executed a Regulatory Capital Maintenance/Dividend Agreement containing the following Miscellaneous provision, which is identical to one in the Dividend Agreement in this case:

> All references to regulations of the Board or the FSLIC used in this Agreement shall include any successor regulation thereto, it being expressly understood that subsequent amendments to such regulations may be made and that such amendments may increase or decrease the Acquiror's obligation under this Agreement.

378 F.3d at 1339. This court interpreted the provision as risk-shifting, stating "by agreeing to the clause, Admiral acknowledged that its obligations might change if the regulatory regime changed." Id.

We held that "Admiral assumed the risk of a regulatory change such as that brought about by FIRREA," and thus, Admiral could not recover damages based on the government's enactment of FIRREA and the implementing regulations. Id. at 1343. In *Franklin*, this court applied its *Admiral* holding, concluding that because the risk-shifting clause in the Dividend Agreement and the promises regarding goodwill in the Forbearance Letters were identical to those found in *Admiral*, the plaintiffs assumed the risk of regulatory change. *Franklin*, 431 F.3d at 1369.

In this case, we are bound by our decisions in *Admiral* and *Franklin*. The government's promises regarding goodwill forbearances are the same here as in *Admiral* and *Franklin*. The clause that this court held was risk-shifting in *Admiral* and *Franklin* is identical to a clause in the Dividend Agreement executed by EPHC. There is nothing in the Dividend Agreement in this case to distinguish it from that in *Admiral* and *Franklin*. *Cf. Hometown*, 409 F.3d at 1365-66, 1369 (holding that the risk of regulatory change with respect to the goodwill forbearances did not shift to the plaintiff because the goodwill promises were specifically excluded from the Dividend Agreement provisions that shifted the risk of regulatory change).

In its cross-appeal, EPHC attempts to distinguish *Admiral* and *Franklin* on the ground that the only consideration given by the government to EPHC was the goodwill forbearance and that if the government could retract this at any time, it was an illusory promise. In contrast, EPHC argues that *Admiral* was premised on the fact that the government had

provided other adequate consideration and that in *Franklin*, the plaintiffs admitted that regulatory approval of the transaction constituted consideration--a fact that EPHC has not conceded in this case. EPHC's attempt to distinguish Franklin is unconvincing for two reasons. First, this court in Franklin already addressed and rejected the illusory promise argument, stating that "[u]nder *Winstar*, a promise for a regulatory waiver until regulatory change occurs is plainly sufficient consideration." *Franklin*, 431 F.3d at 1370. Second, although EPHC has not conceded that regulatory approval constitutes consideration, this court in *Franklin* held that such approval is adequate consideration. *Id.* As in *Franklin*, the Dividend Agreement in this case states that EPHC is agreeing to the commitments stated in the Agreement "in order that the FSLIC will approve the acquisition." See id. at 1367 (the Dividend Agreement stating Franklin's promise to maintain capital was "in consideration of the FSLIC acting favorably on the Application").

The Court of Federal Claims properly concluded that our decisions in *Admiral* and *Franklin* mandate that EPHC assumed the risk of regulatory change and therefore cannot recover for breach of contract based upon the government's enactment of FIRREA. *Hughes II*, 71 Fed.Cl. at 321.

II.

Next, we must determine whether Hughes, as an individual, can recover for the government's alleged breach of contract. This determination rests upon whether or not Hughes was a party to the Dividend Agreement such that the risk-shifting provision

prohibits government liability to Hughes for regulatory changes.

The government contends that there was only one overall agreement in this case, including the Dividend Agreement, so that if this court finds Hughes was a party to the agreement, Hughes assumed the risk of regulatory change. Appellees argue that although Hughes was in privity with respect to the government's promises in separate contractual documents (i.e., the Approval Letter and Forbearance Letter) based on his personal obligations, the Court of Federal Claims properly determined that Hughes was not a party to the Dividend Agreement, and therefore, Hughes can recover for the alleged breach.

The findings made by the Court of Federal Claims on this issue are not entirely clear. In *Hughes I*, the court found that there was only one contract, stating that [EPHC]'s application to acquire El Paso Federal, FHLBB's approval letter, the forbearance letter, and the [Dividend Agreement] are part of the contract." 58 Fed.Cl. at 312 (emphasis added). In *Hughes II*, the court again acknowledged that there was only one overall contract, but then suggested that the Forbearance Letter and the Dividend Agreement should be construed separately, stating "[t]he two documents, while each part of the over-arching contract involved here comprising numerous documents, are separate. Accordingly, one must interpret two separate documents in this contractual melee." 71 Fed.Cl. at 324. The only rationale offered by the Court of Federal Claims as to why the Forbearance Letter and the Dividend Agreement should be separately

construed was that "[t]he Forbearance Letter granting the amortization of supervisory goodwill was unqualified." *Id.* In determining that Hughes was not a party to the Dividend Agreement, the court noted the following facts: "Hughes did not sign the [Dividend Agreement]; the [Dividend Agreement] did not incorporate any of the other contractual documents; the Forbearance Letter is unconditional in its grant of amortization of goodwill forbearance; and the amortization of goodwill forbearance was a condition precedent to the seminal offer here, the [Merger] Agreement." *Id.* at 321.

We begin our analysis by noting that all of the relevant documents in this case relate to the government-approved merger and conversion of the El Paso thrift. The fact that all of the documents relate to the same transaction, however, is not dispositive because in appropriate circumstances, this court has concluded that various thrift conversion documents constituted separate agreements. Specifically, in *Southern California Federal Savings & Loan Assoc. v. United States*, 422 F.3d 1319, 1333 (Fed.Cir.2005), this court found that although the individual plaintiffs were not party to an Assistance Agreement, they were in contractual privity with the government under a Dividend Agreement. In *Southern California*, however, the individual documents contained "Entire Agreement clauses" that specifically incorporated certain outside agreements, but did not incorporate the Dividend Agreement into the Assistance Agreement nor vice versa. Id. at 1330. The present case is different than *Southern California*. This case involves an unassisted transaction, meaning that the government merely approved the acquisition. The

relevant contractual documents do not include an Assistance Agreement, whereby the government agrees to additional promises of financial assistance. *See Hughes II*, 71 Fed.Cl. at 286. In addition, the relevant contractual documents do not contain Entire Agreement Clauses which would indicate separateness of the agreements. Thus, we cannot conclude based on the logic in Southern California that the Forbearance Letter and Dividend Agreement are separate documents such that Hughes could be party to the former but not the latter.

We find the present case analogous to *Franklin*, where this court determined it need not reach individual shareholder standing because the court concluded that the overall agreement containing the goodwill forbearances also shifted the risk to the private parties. 431 F.3d at 1371. In *Franklin*, we held that the Approval Letter and Forbearance Letter were not separate contractual documents from the Dividend Agreement, but rather, they constituted "regulatory approvals that could only become enforceable by the mechanism of the Dividend Agreement." *Id.* at 1365-66. That conclusion is applicable here. In fact, each of the reasons given by the Court of Federal Claims in *Hughes II* as to why Hughes should not be bound by the Dividend Agreement was also present in *Franklin*: (1) the individual plaintiffs were not signatories to the Dividend Agreement, *id.* at 1365; (2) the Dividend Agreement did not incorporate any of the other related contractual documents, id. at 1366; (3) the Forbearance Letter unconditionally granted a goodwill forbearance for amortization over 25 years, id. at 1363; and the amortization of

goodwill forbearance was specifically requested in the application by the private parties, *id.* Also like *Franklin*, the Forbearance Letter in this case was not addressed to the individual shareholder (Hughes), and the Dividend Agreement was signed weeks after execution of the other merger agreements.[2] *Id.* at 1363, 1365.

Although there is no evidence here that the parties explicitly discussed execution of the Dividend Agreement during the merger approval negotiations, as was true in *Franklin*, that does not persuade us that the agreements in this case should be treated separately. For one, the Approval Letter was conditioned upon compliance with all relevant regulatory provisions. The relevant regulations at the time required that controlling shareholders enter into a net worth maintenance agreement, such as the Dividend Agreement, personally agreeing to maintain the institution's regulatory capital. *See* 12 C.F.R. § 571.6(d)(4)(i) (1988); 49 Fed.Reg. 41,237 (Oct. 22, 1984). In addition, many of the relevant contractual documents specifically reference one another, further evidencing their interrelatedness. The Dividend Agreement states that it is in consideration for the government's approval of the merger, as set forth in the Approval Letter. The Approval Letter specifically authorizes the regulators to issue the Forbearance Letter. The

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[2] The Dividend Agreement in this case was actually signed on the closing date of the merger and on the same day that Hughes signed the Agreement of Obligation in his individual capacity. Thus, the timing of the Dividend Agreement further evidences its interrelatedness to the other contractual documents.

Forbearance Letter similarly references that it is in connection with the FHLBB's approval.

For these reasons, we conclude that the series of contractual documents in this case constitute one overall agreement involving the El Paso thrift merger and conversion. If Hughes was a party to that agreement,[3] he too assumed the risk of regulatory change by virtue of the risk-shifting clause in the Dividend Agreement. We therefore reverse the Court of Federal Claims' decision that Hughes could recover from the government for breach of contract.

CONCLUSION

We hold that the Dividend Agreement placed the risk of regulatory change on the private parties, such that they cannot recover for damages resulting from the regulatory capital requirements changed by the government's enactment of FIRREA. Therefore, we need not reach the government's arguments regarding the propriety of the damages awarded to Hughes. The Court of Federal Claims' decision is

AFFIRMED-IN-PART and REVERSED-IN-PART.

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[3] Because we conclude that the goodwill promises from the government were in the same overall agreement as the risk-shifting provision, we need not reach the issue of whether Hughes had individual standing to sue the government based upon his personal obligations under the agreements. Nor do we consider whether the Agreement of Obligation constituted a separate document from the Dividend Agreement because to the extent that it did, it lacked the goodwill forbearances that gave rise to the present cause of action.

UNITED STATES COURT OF FEDERAL CLAIMS

No. 90-878C

Alfred D. HUGHES

and

El Paso Holding Corporation,

Plaintiffs,

v.

The UNITED STATES,

Defendant.

October 23, 2003.

OPINION

MEROW, Senior Judge.

This case is one of the numerous *Winstar*-related cases arising out of the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), Pub.L. No. 101-73, 103 Stat. 183 (1989). The history of the savings and loan crisis of the early 1980's which spawned this litigation is discussed in detail in *United States v. Winstar Corp.*, 518 U.S. 839, 843-861, 116 S.Ct. 2432, 135 L.Ed.2d 964 (1996) (*Winstar III*); *see also Winstar Corp. v. United States*, 64 F.3d 1531, 1536 (Fed.Cir.1995) (*Winstar II*).

Plaintiffs, El Paso Holding Corporation ("El

Paso") and Alfred D. Hughes ("Hughes") (collectively, "plaintiffs"), allege that defendant breached a contractual obligation to forbear from enforcing certain regulatory capital maintenance requirements arising from plaintiffs' "unassisted" acquisition of El Paso Federal Savings and Loan Association ("El Paso Federal").[1] The acquisition was "unassisted" because, in connection with its approval, the government did not enter into an assistance agreement or supervisory action agreement whereby the government provided cash assistance. Defendant counters that the approvals and forbearances granted for the acquisition of El Paso Federal were merely an exercise of its regulatory authority in this regard, and were not contractual in nature.

In the alternative, defendant raises other affirmative defenses. First, it argues that the government entities involved lacked authority to guarantee El Paso against the regulatory change which plaintiffs claim constituted a breach of contract. Second, the government contends that the Regulatory Capital Maintenance/ Dividend Agreement ("RCMDA') signed by El Paso and the Federal Savings and Loan Insurance Corporation ("FSLIC") allocated the risk of the relevant regulatory change to the plaintiffs. Finally, defendant asserts that neither plaintiff has standing to assert a claim for breach of contract. The matter is

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[1] By Order, filed April 5, 2000, the Federal Deposit Insurance Corporation's ("FDIC") motion to intervene was granted. By Order, fled April 28, 2003, FDIC's motion to dismiss, pursuant to RCFC 41(x)(2) was granted and its complaint was dismissed with prejudice. FDIC's motions for summary judgment were denied as moot.

before the court on plaintiffs' motion for summary judgment and defendant's cross-motion for summary judgment.[2] For the reasons asserted below, plaintiffs' motion for summary judgment on liability for breach of contract is GRANTED-IN-PART and DENIED-IN-PART. Defendant's cross-motion for summary judgment is DENIED-IN-PART.

BACKGROUND

I. El Paso Acquisition

El Paso Federal was originally chartered as a mutual savings and loan association in 1929 and received insurance accounts in 1934. As detailed in *Winstar III*, 518 U.S. at 845, 116 S.Ct. 2432, high interest rates and inflation in the 1980's caused many thrifts to fail because the cost of short-term deposits exceeded the revenues from long-term mortgages. According to the Federal Home Loan Bank of Dallas ("FHLB-Dallas"), the Supervisory Agent's digest dated January 20, 1988, El Paso Federal's deteriorating financial condition was largely attributable to these factors. Pls.' Ex. 7.[3] During the increase in deregulated interest rates on

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[2] Defendant has also moved for summary judgment on plaintiffs' takings claim and claims for rescission and pre judgment interest. Because plaintiffs' motion for summary judgment for breach of contract is granted and the remaining issues in this regard relate to resolving breach damages, the court does not address these issues. To the extent they may still be. relevant, they will be addressed in the further proceedings.

[3] Unless otherwise noted, all citations to plaintiffs' exhibits references the Appendices and Exs. to Pls.' Br. in Supp. of Mot. for Summ. J.

deposits in 1981 and 1982, El Paso Federal experienced significant operating losses due to the fact that the cost of funds was increasing faster than its interest income. El Paso Federal responded by increasing the amount of loans originating on non-owner occupied properties in 1983, 1984, and 1985. However, El Paso Federal continued to experience large operating losses because of the high level of non-performing loans.

According to a May 1988 internal Federal Home Loan Bank Board ("FHLBB") memorandum by the Office of General Counsel ("OGC"), E1 Paso Federal reported assets of approximately $247.8 million, total liabilities of $258.8 million, negative regulatory capital of approximately $4 million, and negative net worth on a Generally Accepted Accounting Principles ("GAAP") basis of over $9 million as of November 30, 1987. Pls.' Ex. 9. According to the May 12, 1988 executive summary prepared by the FHLBB's Director of Corporate Activities, Office of Regulatory Policy, Oversight and Supervision ("ORPOS"), El Paso Federal reported total assets of $248.4 million, total liabilities of $259.9 million, and negative regulatory capital of $11.5 million as of March 31, 1988. Pls.' Ex. 8. In a May 1988 internal FHLBB memorandum by OGC, it was noted that the Supervisory Agent and ORPOS "have determined that El Paso Federal currently is insolvent when its capital is calculated under generally accepted accounting principles (`GAAP') on a going concern basis." Pls.' Ex. 9.

On August 13, 1987, Hughes, El Paso, and El Paso Federal entered into an Agreement and Plan of Merger and Supervisory Conversion ("Merger Plan").

Pls.' Ex. 3. Pursuant to the Merger Plan, Hughes and El Paso proposed to acquire El Paso Federal through an El Paso subsidiary, El Paso Savings Association ("New El Paso"). Under the plan, El Paso Federal would convert from a mutual savings and loan association to a state-chartered stock association and merge with and into New El Paso. The resulting institution, New El Paso, would become a wholly-owned subsidiary of El Paso. The Merger Plan included several conditions precedent to the obligations of Hughes and El Paso, including:

> 8.04. Accounting Method. The receipt by Purchasers of an opinion of the Purchaser's independent certified public accountants that the transaction may be accounted for under Generally Accepted Accounting Principles ("GAAP") using purchase or "push-down" accounting, and the approval of this accounting in accordance with GAAP. For Regulatory Accounting Purposes ("RAP"), approval by the FHLBB to allow the accretion of discounts over the estimated or actual portfolio life and the amortization of goodwill using the straight-line method over a twenty-five-year life, or such other life and amortization period as is acceptable to [ORPOSI and Supervision of the Federal Home Loan Bank System
>
> ...
>
> 8.07 Regulatory Waivers. The regulatory forbearances and waivers listed on Schedule 6.01 shall have been granted by the FHLBB or waived by the Purchasers.

Pls.' Ex. 3.[4] According to Schedule 6.01, among the forbearances requested was the amortization of goodwill arising from purchase method accounting, for regulatory purposes, by use of the straight-line method over a 25 year period.

On August 17, 1987, El Paso filed an H-(e)1 application with the FHLBB for approval of a supervisory conversion and merger. The application was signed by El Paso's president, Hughes. According to the Merger Plan, El Paso would own 100 percent of the outstanding common stock of New El Paso in exchange for contributing property valued at $35 million (after debt) and $11.5 million in cash. New El Paso proposed issuing one million shares of common stock to El Paso in exchange for fourteen parcels of real estate controlled by Hughes with a net estimated appraisal value (after debt) of $35 million. According to a May 1988 OGC memorandum, the real estate was initially contributed by Hughes to El Paso and then transferred to New El Paso. Pls.' Ex. 9. It consisted of the Waterford Centre valued at $8.1 million, Steiner ranch valued at $13.4 million, and twelve "section 8" apartments valued at $13.5 million. According to the Supervisory Agent's digest, the "appraisal department of the Federal Home Loan Bank of Dallas inspected all of the properties to be contributed and endorses the values presented above." Pls.' Ex. 7. As detailed below, defendant now

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[4] The purchase method of accounting allows for the recognition of supervisory goodwill for accounting purposes. Supervisory goodwill is calculated as the equivalent of the excess of the fair market value of the liabilities assumed over the fair market value of the assets acquired.

disputes the true value of the properties contributed by Hughes. In order to provide assurance as to the creditworthiness of the "section 8" apartments, Hughes executed a personal guarantee that the cash flow from these properties would not be less than $1 million per fiscal year for ten years. After conveyance of the Steiner Ranch New El Paso paid off the outstanding debt on this property to all third party lenders.[5]

In his individual capacity, Hughes would purchase $1.5 million of Series B subordinated notes issued by New El Paso. New El Paso would also issue $10 million of Series A subordinated notes to retire a portion of the related debt on the Steiner properties. According to the May 1988 internal OGC memoranda, "T.C. Steiner and Son, a Texas General Partnership and Steiner and Sons, Ltd. (the `Steiner Partnerships') will purchase 100,000 shares of the Series A subordinated debt for an aggregate purchase price of $10,000,000 in cash." Pls.' Ex. 9.[6] The purchase of the $10 million of Series A notes was structured differently than the cash purchase of the Series B notes. Plaintiffs have explained that instead of receiving $10 million cash, New El Paso "simply paid out $10 million less than it otherwise would have paid to retire the debt on the contributed properties." Pls.' Supplemental Br. at 6. The total amount owed to Mr. Steiner was $21.5 million. However, New El Paso only paid out $11.5 million.

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[5] The Steiner Ranch had a appraised value of $44.5 million with $34.5 million of outstanding debt.

[6] T.C. Steiner and Son and Steiner and Son, Ltd. are controlled by Mr. Tommy C. Steiner, who had been a business partner of Hughes.

On May 27, 1988, Hughes executed a promissory note payable to Mr. Steiner for the remaining $10 million. App. in Supp. of Pls.' Supplemental Br. at A312 ("Pls.' App."). In addition, New El Paso would make a loan of $34.4 million to a newly formed subsidiary to develop the Steiner Ranch property.

According to an internal FHLBB memorandum prepared by OGC, New El Paso would emerge from the plan with total assets of $328.8 million, total liabilities of $293.3 million, and regulatory capital and GAAP net worth of $46.5 million. Pls.' Ex. 9. On May 13, 1988, the FHLBB, in a letter signed by ORPOS, the Office of the District Bank ("ODB"), and OGC, approved the El Paso application to acquire El Paso Federal and merge it into New El Paso. Pursuant to their delegated authority, the signatories found that the transactions "are instituted for supervisory reasons and are necessary to prevent the probable failure of the Old Institution." Pls.' Ex. 4. The approval letter provided that "[p]ursuant to delegated authority to approve the applications noted herein, the Secretary or an Assistant Secretary of the Board is hereby directed and authorized to issue to the New Institution a letter, effective upon the merger of the Old Institution into the New Institution concerning supervisory forbearances." Pls.' Ex. 4. In addition, the approval letter stated the Secretary of the Board was authorized to issue a certificate of insurance provided that New El Paso "obtain approval of the Federal Home Loan Bank of Dallas pursuant to 12 C.F.R. § 563.8-1 of an application requesting approval to include in the New Institution's Regulatory Capital the proposed $11.5 million worth of subordinated debentures ...." Pls.' Ex. 4.

On the same day, the FHLBB issued a forbearance letter signed by the Board's acting secretary granting six forbearances in association with the supervisory conversion and merger, including:

> 1) ... the Federal Savings and Loan Insurance Corporation ("FSLIC") will forbear, for a period not to exceed five (5) years following consummation of the acquisition ("Effective Date"), from exercising its authority under Section 561.13 of the Insurance Regulations, for any failure of El Paso to meet the net worth requirements of Section 561.13 arising solely from an increase in the contingency factor attributable to El Paso at the date of acquisition.
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> 2) For a period not to exceed five (5) years, from the Effective Date, the FSLIC will forbear from exercising its authority under Section 563.9-8(c)(2)(i) or (ii) or (iii) (Threshold for Equity Risk Investments) of the Insurance Regulations, to allow New El Paso to exclude all investments currently in El Paso's portfolio in determining the amount available for equity risk investments.
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> 3) For purposes of reporting to the Board, the value of any unidentifiable intangible assets resulting from accounting for the merger in accordance with the purchase method may be amortized by New El Paso over a period not to exceed twenty five (25) years by the straight line method, from the Effective Date.
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> 4) Not later than one hundred twenty (120) days following the Effective Date, New El Paso shall submit to the Supervisory Agent an independent

certified public accountant's opinion that New El Paso has accounted for this merger in accordance with generally accepted accounting principles except as herein provided by the Board, for purposes of reporting to the Board, the value any unidentifiable intangible assets resulting from the merger may be amortized by New El Paso over a period not to exceed twenty five (25) years by the straight line method.

Pls.' Ex. 5. On May 27, 1958, El Paso and FSLIC entered into the RCMDA providing:

WHEREAS, the Acquiror has filed the appropriate applications ("Applications") with the FSLIC for approval of its acquisition of El Paso Federal Savings and Loan Association, El Paso, Texas ("El Paso Federal"), by merging El Paso Federal with and into the Acquiror's wholly-owned subsidiary, New El Paso Savings and Loan Association (the "Resulting Institution");

WHEREAS, in reviewing the Applications, the FSLIC must make a determination that the financial and managerial resources and future prospects of the Acquiror, El Paso Federal and the Resulting Institution are not detrimental to the Resulting Institution or the insurance risk of the FSLIC;

...

WHEREAS, the Acquiror is willing to make such a commitment in order that the FSLIC will approve the acquisition.

NOW, THEREFORE, in consideration of the FSLIC approving the acquisition of control of El Paso Federal by the Acquiror, the Acquiror

agrees as follows: ....

App. to Def.'s Cross-Mot. for Summ. J at 207 ("Def.'s App."). Under section II, El Paso agreed that:

> A. As long as the Acquiror shall maintain the Resulting Institution, the Acquiror will cause the Regulatory Capital of the Resulting Institution to be maintained at a level at or above the Regulatory Capital Requirement and as necessary, will infuse sufficient additional capital, in a form satisfactory to the Supervisory Agent, to effect compliance with such requirement and cure a Regulatory Capital Deficiency during the first quarter after which the Resulting Institution fails to meet its Regulatory Capital Requirement.
>
> B. Unless written approval has been obtained from the Supervisory Agent, the Resulting Institution shall not pay, and the Acquiror shall not accept from the Resulting Institution, dividends that exceed 50 percent of the Resulting Institution's net income for the fiscal year ... but in no event may dividends be paid or stock be repurchased by the Resulting Institution that would reduce the Regulatory Capital of the Resulting Institution below the Resulting Institution's Regulatory Capital Requirement.

Def.'s App. at 206. Section VI of the RCMDA also states:

> B. This Agreement shall be deemed a contract made under and governed by Federal law.
>
> C. This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.

...

E. No supplement, modification or amendment of this Agreement shall be binding unless executed in writing by both of the parties.

Def.'s App. at 210. On September 9, 1988, FHLB-Dallas found that the compliance material submitted by plaintiffs was complete and met the requirements contained in the FHLBB's approval letter. Pls.' Ex. 17.

II. FIRREA

Under FIRREA, the FHLBB was replaced by the Office of Thrift Supervision ("OTS") and the OTS Director was responsible for the regulation of all federally insured savings associations and the chartering of all federal thrifts. *Winstar* II 64 F.3d at 1538. The OTS director was required to "prescribe and maintain uniformly applicable capital standards for savings associations." 12 U.S.C. § 1464(t)(1)(A). As a result of FIRREA, New El Paso was unable to meet the minimum tangible, core, and risk-based capital requirements. On July 11, 1990, OTS informed New El Paso that its March 31, 1990 calculation of regulatory capital "incorrectly includes a portion of goodwill as a capital component," and that it had been out of compliance with FIRREA's capital standards on and after February 28, 1990. Pls.' Ex. 20. On August 2, 1990, OTS directed New El Paso "to *immediately* discontinue including supervisory goodwill in the amount of approximately 41.5 million, or in any other amount, in its core capital calculation ...." Pls.' Ex. 21. On July 2, 1990, the Commissioner of the Texas Savings and Loan Department placed New El Paso in a

conservatorship for failing to satisfy federal regulatory capital requirements. On September 7, 1990, OTS placed New El Paso in a receivership for the same reason. Pls.' Ex. 23.

DISCUSSION

I. Jurisdiction

A waiver of traditional sovereign immunity "cannot be implied but must be unequivocally expressed." Saraco v. United States, 61 F.3d 863, 864 (Fed.Cir.1995) (quoting *United States v. King*, 395 U.S. 1, 4, 89 S.Ct. 1501, 23 L.Ed.2d 52 (1969)). In this case, the court has jurisdiction over plaintiffs' claims based on an express or implied contract with the United States pursuant to the Tucker Act, 28 U.S.C. § 1491(a)(1). See *United States v. Connolly*, 716 F.2d 882, 885 (Fed.Cir.1983) (en bane).

II. Summary Judgment

Summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law." RCFC 56(c); *Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S.Ct. 2548, 91 L.Ed2d 265 (1986). A material fact is one that would affect the outcome of the suit. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). Summary judgment will not be granted "if the dispute is `genuine,' that is, if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Id.*

The court must resolve all reasonable inferences in favor of the non-moving party. *Id.* at 255, 106 S.Ct. 2505. The burden on the moving party for summary judgment, to demonstrate that there is no genuine issue of material fact, may be discharged if it can show "that there is an absence of evidence to support the non-moving party's case." *Sweats Fashions, Inc. v. Pannill Knitting Co.*, 833 F.2d 1560, 1563 (Fed.Cir.1987) (quoting *Celotex*, 477 U.S. at 325, 106 S.Ct. 2548). The burden then shifts to the non-moving party to produce evidence setting forth specific facts that there is a genuine issue for trial. *Celotex*, 477 U.S. at 322, 106 S.Ct. 2548. "Mere denials, conclusory statements or evidence that is merely colorable or not significantly probative is not sufficient to preclude summary judgment." Anderson, 477 U.S. at 256, 106 S.Ct. 2505; *Pure Gold, Inc. v. Syntex (U.S.A.), Inc.*, 739 F.2d 624, 627 (Fed.Cir.1984) (citing *Barmag Barmer Maschinenfabrik AG v. Murata Machinery, Ltd.*, 731 F.2d 831, 836 (Fed.Cir.1984)) (holding that non-movant "must set out, usually in an affidavit from one with personal knowledge of specific facts, what specific evidence could be offered at trial."). Instead, to create "a genuine issue of fact, the nonmovant must do more than present some evidence on an issue it asserts is disputed." *Avia Group Intl, Inc. v. L.A. Gear Cal., Inc.*, 853 F.2d 1557, 1560 (Fed.Cir.1988).

III. Contract Formation

A. Contract Principles

The Supreme Court in *Winstar III* directed courts deciding Winstar-related cases to apply "ordinary

principles of contract construction and breach that would be applicable to any contract between private parties." 518 U.S. at 871, 116 S.Ct. 2432. Whether a contract exists is a mixed question of law and fact. *Cienega Gardens v. United States*, 194 F.3d 1231, 1239 (Fed.Cir.1998). "The requisite elements of contract with the government are no different in *Winstar* cases than in other cases in which a contract with the government is alleged: mutual intent; including an unambiguous offer and acceptance; consideration; and authority on the part of the government representative to bind the government." *First Commerce Corp. v. United States*, 335 F.3d 1373, 1379-80 (Fed.Cir.2003). These general requirements apply equally to an express and an implied contract. *Trauma Serv. Group v. United States*, 104 F.3d 1321, 1325 (Fed.Cir.1997). In *Winstar III*, the Supreme Court concluded that a contract existed between the government and financial institutions based in-part on assistance agreements and supervisory action agreements with integration clauses. 518 U.S. at 864-66, 116 S.Ct. 2432.

In *California Fed. Bank, F.S.B. v. United States*, 245 F.3d 1342 (Fed.Cir.2001) (*CalFed II*), *cert. denied*, 534 U.S. 1113, 122 S.Ct. 920, 151 L.Ed2d 884 (2002), the Federal Circuit held that the parties entered into a contract allowing the amortization of supervisory goodwill even in the absence of any assistance agreement or supervisory action agreement with an integration clause. The Federal Circuit concluded that:

> [I]f the factual records of individual cases show intent to contract with the government for

> specified treatment of goodwill, and documents such as correspondence, memoranda, and [FHLBB] resolutions confirm that intent, the absence of an [assistance agreement] or [supervisory action agreement] should be irrelevant to the finding that a contract existed.

CalFed II, 245 F.3d at 1347.

However, there "needs to be something more than a cloud of evidence that could be consistent with a contract to prove a contract and enforceable contract rights." *D & N Bank v. United States*, 331 F.3d 1374, 1377 (Fed.Cir.2003). Instead, plaintiff must be able to "identify with particularity an offer memorializing the terms that it allegedly proposed to the government ...." *First Commerce*, 335 F.3d at 1380.

B. Contemporaneous Documents and Surrounding Circumstances

Plaintiffs contend that the FHLBB's approval of their acquisition and supervisory conversion of El Paso Federal into New El Paso, along with the Merger Plan, correspondence, memoranda, forbearance letter and RCMDA, formed the contract at issue. The government argues that the evidence regarding the supervisory conversion and merger of El Paso Federal into New El Paso reflects nothing more than the FHLBB's routine exercise of its regulatory authority to approve such transactions. However, the Federal Circuit has recently affirmed that "the argument that the government is immune from contractual liability because it was acting in its regulatory capacity was rejected squarely by this court and the Supreme Court in Winstar." *First Commerce*, 335 F.3d at 1383. The Federal Circuit

went on to state:

> The issue in this case, as in other Winstar cases, is whether the government, in exchange for First Commerce's agreement to rescue a failing thrift, also made promises that certain regulatory treatment would be extended and maintained: namely, treating supervisory goodwill as regulatory capital and permitting its amortization over an extended period of time.

Id.

Plaintiffs' claim that they agreed to save El Paso Federal is supported by the FHLBB's approval letter stating that the "transactions are instituted for supervisory reasons and are necessary to prevent the probable failure of the Old Institution." Pls.' Ex. 4. In Article 6.01 of the Merger Plan, it stated that the transaction was conditioned on the approval of the requested forbearances "in form and substance reasonably satisfactory" to all the parties. Pls.' Ex. 3. Among the forbearances requested was the "amortization of goodwill arising from purchase accounting for regulatory purposes, by use of the straight-line method over a 25 year period." Pls.' Ex. 3. Plaintiffs' application for acquisition and merger of El Paso Federal clearly stated that "an integral part of this Application is the assumption that FHLBB will act quickly on this Application and will grant certain regulatory forbearances to the Applicant as a result of its acquisition of El Paso Savings. A complete schedule of requested forbearances appears in the Business Plan attached to part II of the Application." Def.'s App. at 64. The Merger Plan attached to the application requested several forbearances, including "amortization of

goodwill arising from purchase accounting, for regulatory purposes, by use of the straight-line method over a 25 year period." Def.'s App. at 151. In *Admiral Fin. Corp. v. United States*, 54 Fed.Cl. 247, 256 (2002), the court held that an identical provision in the merger plan was "not merely an exercise of the FHLBB's regulatory powers--the merger was conditioned on terms `reasonably satisfactory to Admiral.' This is the language of a party to a contract, not an entity routinely submitting to a regulatory entity."

In its most recent *Winstar* decision, *Anderson v. United States*, 344 F.3d 1343 (Fed.Cir.2003), the Federal Circuit confirmed that a similar request for amortization of goodwill constituted an offer. In its initial application, Westport, the acquiring institution in Anderson requested certain supervisory forbearances and waivers in exchange for infusing capital into a failing thrift. In a subsequent amendment, the acquiring institution specified that the purchase method of accounting would be used to amortize goodwill on a straight-line basis over a specified period of years. The Circuit agreed "with the Court of Federal Claims that Westport and David L. Paul asked for permission to amortize goodwill on a straight-line basis as a condition of acquiring Dade S & L." *Id.* at 1353-54. In *CalFed II*, 245 F.3d at 1345, the Federal Circuit concluded that a similar request in the Family transaction for a "commitment regarding amortization of goodwill was contained in the Acquisition Agreement, Article 6.1(a), which stated that the resulting institution of Cal Fed and Family may amortize any goodwill created under the purchase method of accounting using the straight

line method over the useful life of 40 years." Similar to the El Paso Merger Plan, the "amortization was structured in the agreement as a condition precedent to Cal Fed's obligations." *Id.* The *Anderson* court reaffirmed its holding in *CalFed II*, concluding "the acquiring institution made a specific written offer by requesting, as a condition of its acquisition of failing thrifts, permission to adopt `purchase method of accounting using the straight line method....'" 344 F.3d at 135758.

The Federal Circuit has "previously held that forbearance letters may demonstrate a contractual obligation by the government `to recognize the supervisory goodwill and the amortization periods reflected in the forbearance letters.'" *First Commerce*, 335 F.3d at 1381 (quoting *CalFed II*, 245 F.3d at 1347). The FHLBB approval letter issued to plaintiffs provided that "the Secretary or an Assistant Secretary of the Board is hereby directed and authorized to issue to the New Institution a letter, effective upon the merger of the Old Institution into the New Institution concerning supervisory forbearances." Pls.' Ex. 4. The government responds that neither the acquisition approval letter nor the forbearance letter contain any promise to allow New El Paso to record supervisory goodwill as an asset to be included in its regulatory capital. However, that is precisely what the forbearance letter promised when it stated that "for purposes of reporting to the Board, the value of any unidentifiable intangible assets resulting from accounting for the merger in accordance with the purchase method may be amortized by New El Paso over a period not to exceed twenty five (25) years by the straight line method ...." Pls.' Ex. 5. The

forbearance letter also required New El Paso to submit an accountant's letter that it had accounted for the merger in accordance with GAAP "except as herein provided by the Board, for purposes of reporting to the Board, the value any unidentifiable intangible assets resulting from the merger may be amortized by New El Paso over a period not to exceed twenty five (25) years by the straight line method." Pls.' Ex. 5.

The Federal Circuit interpreted an identical provision in the forbearance letter in the *Winstar* case "as an express agreement allowing Winstar to proceed with the merger plan approved by the Bank Board, including the recording of supervisory goodwill as a capital asset for regulatory capital purposes to be amortized ...." 64 F.3d at 1544; *Anderson*, 344 F.3d at 1356-57 ("The Bank Board made a manifest contractual promise to Winstar in its forbearance letter, agreeing to permit extended amortization of goodwill ...."}. The FHLBB went beyond mere regulatory language when it agreed:

> For purposes of reporting to the Board, the value of any intangible assets resulting from accounting for the merger in accordance with the purchase method may be amortized by [Winstar] over a period not to exceed 35 years by the straight-line method ....

64 F.3d at 1544.

In *CalFed II*, the Federal Circuit found that "the FHLBB and the FSLIC were contractually bound to recognize the supervisory goodwill and the amortization periods reflected in the forbearance letters." 245 F.3d at 1347; *Sterling Savings v. U.S.*,

53 Fed.Cl. 599, 609-610 (2002). In First Commerce, the Circuit found that an identical forbearance letter, issued pursuant to an approval letter signed by ORPOS and OGC, "express the government's promise to offer favorable accounting treatment, ..." 335 F.3d at 1373. As the Federal Circuit has explained, "if the Bank Board had wanted to permit such depreciation of goodwill, it knew how to do so, as it did in contracting with Winstar." *Anderson*, 344 F.3d at 1357-58. In this case, the government did exactly that when it when it issued the approval and forbearance letters clearly manifesting its intent to accept plaintiffs' offer and be bound by the terms of the resulting contract.

The FHLBB approval letter, forbearance letter and various internal memoranda reviewing the application confirm that the government entered into a contract allowing New El Paso to count supervisory goodwill toward regulatory capital and amortize it over a 25 year period. On January 20, 1988, the Principal Supervisory Agent ("PSA") informed ORPOS that the requested forbearances included" amortization of goodwill arising from purchase accounting, for regulatory purposes, by use of the straight-line method over a 25 year period." Pls.' Ex. 7. The PSA confirmed that it had no supervisory objection to the requested forbearance. The ORPOS executive summary states "EPHC has requested the following forbearances in connection with this transaction; ... (6) Amortization of goodwill arising from the purchase accounting, for regulatory purposes, by use of straight line method over a twenty five (25) year period; ...." Pls.' Ex. 8. It recommended that FHLB-Dallas "takes no supervisory objection to the requested forbearances

in items ... 6 ... with which we concur." Pls.' Ex. 8.

Defendant attempts to distinguish *CalFed II* by arguing that the El Paso acquisition more closely resembles cases where no contract has been found. Specifically, defendant argues that the facts of this case are controlled by *D & N Bank*, 331 F.3d at 1374; *Advance Bank, F.S.B. v. United States*, 52 Fed.Cl. 286 (2002); *Fifth Third Bank of W. Ohio v. United States*, 52 Fed.Cl. 264 (2002); and *Anchor Sav. Bank, F.S.B. v. United States*, 52 Fed.Cl. 406 (2002). However, the El Paso transaction is distinguishable from each of these cases. Defendant's reliance on *D & N Bank* is misplaced because the "presence of the forbearance letter distinguishes this case from D & N Bank, in which there were no written documents articulating the government's agreement to provide favorable accounting treatment." *First Commerce*, 335 F.3d at 1381. In *Advance*, the court found that the "conditional approval letter here contrasts starkly with the forbearance letters issued in *California Federal*, which, following a detailed description of purchase accounting and the periods for goodwill amortization and accretion of discount, expressly stated: ...." 52 Fed.Cl. at 289.

In *Anchor*, the court distinguished *CalFed II* because the transaction lacked either an assistance agreement or a forbearance letter. 52 Fed.Cl. at 420. In fact, the court remarked that "the critical facts for the Federal Circuit amount to the `supervisory goodwill and the amortization periods reflected in the forbearance letters." *Id.* In *Fifth Third*, the court denied the plaintiff's motion for summary judgment because the "instant record does not contain an explicit communication from FHLBB to plaintiff

regarding the use of the purchase method to account for the transaction, the amortization of goodwill, or the inclusion of goodwill in computing regulatory capital requirements." 52 Fed.Cl. at 271. In contrast, the court held:

> The record for two of the three transactions in Winstar included such a communication. With regard to the Winstar transaction, a forbearance letter from FHLBB to the plaintiff "stated that intangible assets resulting from the use of purchase method of accounting `may be amortized ... over a period not to exceed 35 years by the straight-line method.'" ... Likewise, in *CalFed* the record for the Brentwood Savings and Loan Association transaction revealed that FHLBB "issued a forbearance letter stipulation that the resulting association may amortize any goodwill created over 35 years." 245 F.3d at 1345. Similarly, FHLBB issued a forbearance letter confirming *CalFed's* entitlement to record the Family Savings and Loan transaction "under the purchase method of accounting and amortize resulting goodwill over 40 years." *Id.*

52 Fed.Cl. at 271 n. 12. Thus, each of the cases cited by defendant are distinguishable from *CalFed II* because those transactions lacked any documents such as a forbearance letter that manifested a mutual intent to enter into a goodwill contract. In the El Paso transaction, there are written documents specifically memorializing the government's acceptance of plaintiffs' offer regarding the accounting treatment of supervisory goodwill.

Defendant argues that the lack of mutual intent to contract is demonstrated by an absence of

extensive negotiations regarding supervisory goodwill. In *Winstar II*, 64 F.3d at 1542, the court stated that if the parties did not intend to use supervisory goodwill for regulatory capital "there would simply be no reason for the extensive negotiations and conditions regarding its use." As discussed above, the Merger Plan, the acquisition application, the various correspondence and memoranda, the . FHLBB approval letter, forbearance letter, and RCMDA demonstrate that the parties did indeed intend to enter into such a contract. In Admiral, the court held:

> The Federal Circuit certainly was not establishing "negotiations" as a litmus test. It merely observed that extensive negotiations prompted by the Government was consistent with an intent by each party to be contractually bound regarding the regulatory forbearances. The history of negotiations may sometimes be looked at to determine contractual intent. But in the end it is only a guidepost.

54 Fed.Cl. at 255. It then concluded that the documents "all support the Plaintiffs position that the parties intended to and did enter into a contractual agreement ...." Id. at 256. Similarly, the contemporaneous documents in this case confirm that the government contractually agreed to plaintiffs' specific requests for purchase method accounting and the treatment of supervisory goodwill.

IV. Breach

The contractual agreement authorizing the use of purchase method accounting and its amortization

over a 25 year period was breached by FIRREA. As described earlier, FIRREA prevented New El Paso from using its supervisory goodwill in meeting its minimum regulatory capital requirements. As such, the OTS regulations were a breach of the government's promise that New El Paso could include supervisory goodwill in regulatory capital and amortize it over an extended period. *Winstar II*, 64 F.3d at 1544-45; *CalFed II*, 245 F.3d at 1348.

V. Contracting Authority

A. FHLBB's Authority

Defendant argues that the FHLBB lacked the statutory authority to guarantee a thrift holding company, such as El Paso, against the risk of regulatory change. The government argues that the statute relied upon by the Supreme Court and the Federal Circuit, 12 U.S.C. § 1729(f)(2) (repealed),[7] only provides authority for the FHLBB to guarantee against loss to "insured institutions." Instead, it asserts that 12 U.S.C. § 1730a(m) and § 1729(f)(3)

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[7] 12 U.S.C. § 1729(f)(2) provides that FSLIC may prescribe:

(i) to purchase any such assets or assume any such liabilities;

(ii) to make loans or contributions to, or deposits in, or purchase the securities of, such other institution...;

(iii) to guarantee such other institution ... against loss by reason of such other institution's merging or consolidating with or assuming the liabilities and purchasing the assets of such insured institution; or

(iv) to take any combination of the actions referred to in clauses (i) through (iii).

govern non-insured institutions, such as El Paso.

Plaintiffs counter that the FHLBB had authority under section 1729(f)(2) because El Paso Federal merged with New El Paso, an insured institution, through a supervisory conversion. As the May 13, 1988 FHLBB approval letter stated, "[New El Paso] is hereby granted FSLIC insurance of accounts and the Secretary or the Assistant Secretary of the Board is authorized to issue a certificate of insurance to New El Paso] ...." Pls.' Ex. 4. In the same letter, the Bank Board approved "a voluntary supervisory conversion in which [El Paso Federal] will be merged with and into [New El Paso], an interim state stock savings and loan association, to be organized by El Paso Holding Corporation ...." Pls.' Ex. 4. Therefore, plaintiffs contend that this involved a merger of insured institutions under section 1729(f)(2). *See Hometown Fin., Inc. v. United States*, 53 Fed.Cl. 326, 335 (2002) (holding that a voluntary supervisory conversion by a holding company through a newly-acquired thrift was a merger under 12 U.S.C. § 1729(f)(2)). However, defendant argues that New El Paso was not an insured institution because the Secretary's certificate of insurance was conditioned on the fact that "[New El Paso] has consummated its merger with [El Paso Federal] and [New El Paso] has not opened for business prior to such merger ...." Pls.' Ex. 4. *See Home Sav. of Am. v. United States*, 50 Fed.Cl. 427, 441-42 (2001) (concluding that similar transaction was governed by section 1729(f)(3) acquisitions instead of a merger of two insured institutions).

Even if defendant is correct that section 1729(f)(2) does not apply, sections 1729(f)(3) and

1730a(m) provide ample statutory authority for FSLIC to enter into a contract with El Paso in this situation. Section 1729(f)(3) states:

> The Corporation may provide any person acquiring control of, merging with, consolidating with or acquiring the assets of an insured institution under section 1730a(m) of this title with such financial assistance as it could provide an insured institution under this subsection.

12 U.S.C. § 1729(f)(3)(1988). Section 1730a(m) provides that FSLIC "may authorize any company to acquire control of said insured institution or to acquire the assets or assume the liabilities thereof." 12 U.S.C. § 1730a(m)(1)(A)(i)(1988). Section 1730a(m) also states that FSLIC's authority under this statute "shall be on such terms as the Corporation shall provide." 12 U.S.C. § 1730a(m)(1)(A)(ii). As such, it provides general contracting authority for FSLIC to guarantee against the risk of loss. *Globe Savs. Bank, F.S.B. v. United States*, 55 Fed.Cl. 247, 259 (2003) ("This section literally gives the FSLIC *carte blanche* to set the terms of a contract in an emergency acquisition.") (emphasis in original).

According to the government, the court should "interpret section 1729(f)(3)'s limited authorization to include only the provision of direct, immediate payments to non-insured entities-not the ability to enter into a contractual relationship guaranteeing against loss." Def.'s Cross-Mot. for Summ. J. at 40. Although the term "financial assistance" is not defined in the statute, defendant argues that it includes assuming liabilities or making loans under subsections 1729(f)(2)(i)-(ii) but does not include

guaranteeing against loss under subsection (iii). However, as the court said in *Globe Savs.*, 55 Fed.Cl. at 260, the "controlling precedent and the breadth of the term `financial assistance' both provide adequate independent grounds for this Court's holding that the FHLBB and the FSLIC had full authority to contract with a holding company to bear the risk of regulatory change." *See also Hometown*, 53 Fed.Cl. at 335 n. 10 ("The court finds that the term financial assistance' does not exclude guarantees against risk of loss, because such guarantees are certainly a form of `financial assistance.'"); *Admiral*, 54 Fed.Cl. at 258 ("The Government provided financial assistance in the form of incentives respecting the regulatory treatment of goodwill.").

Furthermore, defendant's argument ignores controlling case law establishing FHLBB's broad authority to enter into contracts under 12 U.S.C. § 1725(c). The court "cannot ignore the Circuit's holding that the FSLIC's general contracting authority is sufficient to establish a binding commitment to bear the risk of regulatory change." *Hometown*, 53 Fed.Cl. at 334. The Federal Circuit clearly held:

> We have already answered the question of whether the FHLBB and the FSLIC have the authority to enter into contracts like these in the affirmative [in *Winstar Corp. v. United States*, 64 F.3d 1531, 15481. Since its inception, the FSLIC has had the authority under 12 U.S.C. § 1725(c)(3) to make contracts. Further, both the FSLIC and its supervisory agency, the FHLBB, have had the "authority both to extend assistance to acquirers of insolvent FSLIC-insured thrifts,

> 12 U.S.C. § 1729(f)(2)(A) (repealed), and to set minimum capital limits on a case-by-case basis, 12 U.S.C. § 1730(t)(2) (repealed)."

CalFed II, 245 F.3d at 1347 (internal citations omitted).

In *Winstar III*, the Supreme Court confirmed:

> [T]here is no question ... that the Bank Board and FSLIC had ample statutory authority to ... promise to permit respondents to count supervisory goodwill and capital credits toward regulatory capital and to pay respondents' damages if that performance became impossible. The organic statute creating FSLIC as an arm of the Bank Board, 12 U.S.C. § 1725(c) (1988 ed.) (repealed 1989), generally empowered it "to make contracts," and § 1729(f)(2), enacted in 1978, delegated more specific powers in the context of supervisory mergers .... Congress specifically recognized FSLIC's authority to permit thrifts to count goodwill toward capital requirements when it modified the National Housing Act in 1987 [citing 12 U.S.C. § 1730h(d) (1988 ed.) (repealed)] ....

518 U.S. at 890-91, 116 S.Ct. 2432.

In *Winstar III*, both Statesmen and Winstar were holding companies. As such, the Supreme Court "also must have relied upon the FSLIC's plenary power to enter into contracts, pursuant to subsection 1725(c)(3)." *Globe Savs.*, 55 Fed.Cl. at 258; *See also Franklin Fed. Sav. Bank v. United States*, 53 Fed.Cl. 690 (2002); *Admiral*, 54 Fed.Cl. at 247. Thus, defendant's argument that the FHLBB and FSLIC lacked statutory authority to guarantee a holding

company against the risk of loss is unconvincing and contrary to controlling precedent.

B. OGC and ORPOS Authority

As an extension of this argument, defendant contends that the authority delegated by the FHLBB to the OGC and ORPOS did not include the ability to guarantee against the risk of loss. The FHLBB's approval letter stated that OGC, ODB, and ORPOS approved "all of the aforesaid applications pursuant to the authority delegated by the [FHLBB] and the FSLIC in 12 C.F.R. §§ 546.2, 562.7, 563.22, 563.b28(c), and 574.8(b) ...." Pls.' Ex. 4. 12 C.F.R. § 563b.28(c) (1988), governing voluntary supervisory stock conversions, states:

> The Board delegates to the General Counsel or his designee, the authority to approve applications for voluntary supervisory conversions, and to *exercise the authority of the Board* pursuant to this section, provided that (1) the application does not present a significant issue of law or policy, and (2) that ORPOS does not raise supervisory objection to the application ....

12 C.F.R. § 563b.28(c) (emphasis added).

Because the government argues that the FHLBB lacked the statutory authority to guarantee a thrift holding company, such as El Paso, against the risk of regulatory change under 12 U.S.C. §§ 1729(f)(2)-(3), OGC and ORPOS could not, by delegation, gain authority exceeding that of the FHLBB to enter into such a contract with El Paso. Therefore, defendant contends that the approval letter signed by OGC and

ORPOS guaranteeing against risk of loss exceeded any authority originally possessed by the Board. However, because the FHLBB and FSLIC's authority to provide financial assistance under sections 1729(f)(3) and 1725(c) included guaranteeing against the risk of regulatory change, the approval letter by OGC and ORPOS was not unauthorized. OGC and ORPOS were merely exercising the same statutory authority granted to the FHLBB and FSLIC. *Globe Savs.*, 55 Fed.Cl. at 260; *Hometown*, 53 Fed.Cl. at 335 n. 10; *Admiral*, 54 Fed.Cl. at 258.

In *Franklin*, 53 Fed.Cl. at 708, where a thrift holding company acquired a failing thrift through a supervisory conversion, the court held "the contract documents in this case, all of which were drafted by the Government, clearly indicate that the Bank Board and FSLIC officials with whom plaintiffs dealt in 1988 and 1989 were authorized to enter into a goodwill contract." The contract documents relied upon by the court include the very same type of documents involved in the El Paso transaction: a business plan conditioned on approval of requested forbearances, an application for supervisory conversion, an approval letter, a forbearance letter, and a dividend agreement. The approval letter issued in *Franklin* contains language that is almost identical to the one issued in the current case. The approval letter signed by OGC and the Office of Regulatory Activities ("ORA') stated that "pursuant to delegated authority to approve the applications noted herein, the Secretary or an Assistant Secretary of the [Bank] Board is hereby directed and authorized to issue to [Morristown] a letter concerning supervisory forbearances ...." *Id.* at 696.

Pursuant to that delegated authority the Board's Acting Secretary issued a forbearance letter stating that "[f]or purposes of the reporting to the [Bank] Board, the value of any unidentifiable intangible assets resulting from accounting for the acquisition in accordance with the purchase method may be amortized by Franklin Federal Savings Bank over a period not to exceed 25 years by the straight line method." *Id.*

Relying on 12 U.S.C. § 1725(c), the *Franklin* court rejected the argument that an approval letter signed by OGC and ORA, pursuant to delegated authority from the FHLBB lacked statutory authority. *Id.* at 708. ("The Government's cavalier dismissal of 12 U.S.C. § 1725(c) as a `housekeeping' statute does not square with the Supreme Court's reference to that statute in *Winstar III*."). As such, the court concluded that "the contractual undertaking between the Franklin Plaintiffs and the Government clearly includes a promise by Bank Board and FSLIC officials, acting with delegated authority, that Franklin Federal could amortize its supervisory goodwill over 25 years." Id. at 709. The approval letter in *Franklin* is indistinguishable from the approval letter issued under delegated authority by OGC and ORPOS to El Paso. In both cases, the FHLBB with statutory authority to guarantee against the risk of regulatory change under 12 U.S.C. §§ 1725(c)-1729(f), properly delegated its authority under the regulations.

In addition, plaintiffs' argument on the authority issue is strengthened by the fact that PSAs possess authority to bind the FHLBB to promises regarding the amortization of supervisory goodwill. *California*

Fed. Bank v. United States, 39 Fed.Cl. 753 (1997) (CalFed I), affd, 245 F.3d 1342 (Fed.Cir.2001) (CalFed II). In *Fifth Third Bank of W. Ohio v. United States*, 52 Fed.Cl. 637 (2002), the court examined the expansion of the district banks' authority to approve supervisory mergers. In upholding the PSA's authority, the court held that the "ability of the regional banks to make promises regarding the use of supervisory goodwill therefore was integral to fulfilling their role in FHLBB's policy to encourage the private acquisition of failing thrifts." Id. at 643. *See also Commercial Fed. Corp. v. United States*, 55 Fed.Cl. 595 (2003) (holding that PSA had implied authority to bind the FHLBB); *First Fed. Lincoln Bank v. United States*, 54 Fed.Cl. 446, 453 (2002) ("In accordance with the delegation regulations, the regional bank in this case had implied authority to bind itself to promises regarding amortization and use of goodwill toward regulatory capital."). Relying on this caselaw, plaintiffs contend that OGC and ORPOS were given greater authority because they were given control over "[a]ny other action which would otherwise be delegated to the Principle Supervisory Agent pursuant to paragraphs (a)(1) and (3) of this section." 12 C.F.R. § 574.8(b)(3)(ii) (1988).

The government also contends that OGC and ORPOS exceeded their authority delegated under 12 C.F.R. § 574.8(b) (1988). This provision, delegating authority to approve applications for acquisition of control of insured institutions, states:

> The Director of the Office of Examinations and Supervision with the concurrence of the General Counsel or their respective designees are

authorized to take the following actions:

(1) Approve any application or issue notice of intent not to disapprove any notice

(i) which does not raise a significant issue of law or policy..., and (ii) which does not involve regulatory capital maintenance or dividend conditions that fail to conform to paragraph (a)(1)(iv) of this section.

12 C.F.R. § 574.8(b).

Defendant repeats its argument that the FHLBB lacked statutory authority to guarantee a holding company against the risk of regulatory change. Therefore, defendant argues that allowing OGC and ORPOS to make such a promise would raise a significant issue of law requiring them to seek approval directly from the Bank Board. Defendant submits that if El Paso "was not bound by the terms of the [RCMDA] which required it to ensure that [New El Paso] remained in compliance with present and future regulatory capital maintenance requirements, then the OGC and ORPOS exceeded their authority by approving [El Paso's] acquisition of [El Paso Federal]." Def's Cross-Mot. for Summ. J. at 42. However, as described above, the FHLBB's power to provide financial assistance in the form of a guarantee to a holding company acquiring control of an insured institution is clearly provided for under statutory authority. The May 1988 memorandum by OGC explicitly states:

The Director of ORPOS, with the concurrence of OGC (or their respective designees), have been delegated authority to approve the Application pursuant to 12 C.F.R. § 574.8(b), because (i) the

> subject application does not raise a significant issue of law or policy, and (ii) the regulatory capital maintenance and dividend limitation conditions involved are consistent with those set forth in 12 C.F.R. § 574.8(a)(1)(iv).

Pls.' Ex. 9. Furthermore, plaintiffs did not agree to bear the risk of regulatory change regarding the treatment of supervisory goodwill.

VI. Risk of Regulatory Change ("Successor Regulation")

The government argues that even if the FHLBB had authority to enter into a contract, the RCMDA assigned the risk of regulatory change with regard to supervisory goodwill to plaintiffs. Defendant contends that El Paso agreed to provide additional capital if regulatory requirements changed and assumed the risk that the new regulations would prevent it from including supervisory goodwill as a capital asset. The government points to section VI.D. providing that:

> All references to regulations of the Board or the FSLIC used in this Agreement shall include any successor regulation thereto, it being expressly understood that subsequent amendments to such regulations may be made and that such amendments may increase or decrease the Acquiror's obligation under this Agreement.

Def's App, at 210. Under the RCMDA, section I.D., "'Regulatory Capital' means regulatory capital defined in accordance with 12 C.F.R. § 561.13 or any successor regulation thereto." Def's App. at 207. "Regulatory Capital Requirement" is defined as "the

Resulting Institution's regulatory capital requirement at a given time computed in accordance with 12 C.F.R. § 561.13(b), or any successor regulation thereto." Def.'s App. at 207, § I.E. The government relies upon these provisions as support for the contention that El Paso promised to bear the risk of regulatory change. Defendant explains that the Supreme Court recognized that:

> [E]ach side could have eliminated any serious contest about the correctness of their interpretative positions by using clearer language. *See, e.g., Guaranty Financial Services, Inc. v. Ryan*, 928 F.2d 994, 999-1000 (C.A.11 1991) (finding, based on very different contract language, that the Government had expressly reserved the right to change the capital requirements without any responsibility to the acquiring thrift.)

Winstar III, 518 U.S. at 869 n. 15, 116 S.Ct. 2432. In *Guaranty*, the court interpreted "the forbearance provision to mean that the agencies would allow Guaranty to treat supervisory goodwill as regulatory capital so long as the regulatory [sic] remained as it was when the contract was signed.... But the agencies, at the same time they made that promise, also unambiguously warned Guaranty that rules might later change to Guaranty's detriment." 928 F.2d at 999. Defendant argues that the Regulatory Capital Maintenance Agreement ("RCMA") language in *Guaranty* is identical to the RCMDA issued in the present case. As such, the RCMDA shifted any risk of regulatory change from the government to El Paso.

First, as the *Franklin* court noted, "the reference

to *Guaranty* in *Winstar III* was too fleeting and peripheral to be accorded precedential weight." 53 Fed.Cl. at 714. Secondly, this issue has been dealt with extensively by the Court of Federal Claims and has been consistently rejected. In fact, the "successor regulation" argument was one of the early common issues decided. *CalFed I*, 39 Fed.Cl. at 779 ("The court is required to follow the Supreme Court and reject Defendant's argument that `successor regulation' language shifted the risk from the government to BF."). In *Winstar II*, the Federal Circuit held that the "stipulation by Winstar to maintain its regulatory net worth at whatever level the regulators set does not, however, eclipse the government's own promise that Winstar could count supervisory goodwill in meeting the regulatory requirements with which it had promised to comply." 64 F.3d at 1544. In *Castle v. United States*, 42 Fed.Cl. 859, 863-64 (1999), *vacated in part, af'd in part and rev'd in part on other grounds*, 301 F.3d 1328 (Fed.Cir.2002), the court rejected a similar "successor regulation" defense:

> Defendant would have the court accept an interpretation whereby a very specific provision of the agreement setting forth the unique means by which the thrift may meet its capital standards, and designed to induce capital investment in the thrift and to permit the thrift the flexibility in the near term to turn the fortunes of Western Empire around, could be destroyed at any time for any reason.

In *Castle*, the court found that specific language in the RCMA, identical to the RCMDA in this case, had to be read in light of the entire contract and

harmonized with all of the forbearance provisions. 42 Fed.Cl. at 863-64. The court held that the most reasonable interpretation was that the government allowed plaintiffs to count supervisory goodwill toward its regulatory capital while permitting the government to adjust the minimum regulatory capital level. *Id.*

Plaintiffs contend that defendant's interpretation would violate the basic contract principle that an interpretation of a contract "must assure that no contract provision is made inconsistent, superfluous, or redundant." *Lockheed Martin IR Imaging Sys., Inc. v. West*, 108 F.3d 319, 322 (Fed.Cir.1997); *United States v. Johnson Controls, Inc.*, 713 F.2d 1541, 1555 (Fed.Cir.1983) ("An interpretation that gives reasonable meaning to all parts of the contract will be preferred to one that leaves portions of that contract meaningless ...."}. Plaintiffs argue that the RCMDA "successor regulation" provision must be read in conjunction with the forbearance letter as part of the overall contract. *Dalton v. Cessna Aircraft Co.*, 98 F.3d 1298, 1305 (Fed.Cir.1996) ("We read the language of a particular contractual provision in the context of the entire agreement ...."). The forbearance letter provided that:

> For purposes of reporting to the Board, the value of any unidentifiable intangible assets resulting from accounting for the merger in accordance with the purchase method may be amortized by New El Paso over a period not to exceed 25 years by the straight line method.

Pls.' Ex. 5. The forbearance letter went on to state:

> This letter does not and shall not be construed to

> constitute forbearance or waiver by the Board or the FSLIC with respect to any regulatory or other requirements *other than those encompassed within the preceding paragraphs (1) through (6).* Other than the actions to enforce the regulatory requirements waived in accordance with paragraphs (1) through (6) and the statutory provisions authorizing imposition of the waived requirements, insofar as such requirements are waived, the Board and FSLIC expressly reserve all of their statutory rights and powers with respect to New El Paso ....

Pls.' Ex. 5 (emphasis added).

Plaintiffs persuasively argue that the specific language in the forbearance letter is part of the overall contract and takes precedence over the general language contained in the RCMDA. *Franklin*, 53 Fed.Cl. at 715 ("The court agrees with the plaintiffs' position that the specific language of the Forbearance Letter ... takes precedence over the more general `successor regulation' provision (Sec. VIII.D.) of the Dividend Agreement."); *Hometown*, 53 Fed.Cl. at 337; Admiral, 54 Fed.Cl. at 257. The forbearance letter specifically recognized the forbearance allowing New El Paso to report supervisory goodwill as amortizable regulatory capital for twenty-five years while reserving the government's right with regard to all other statutory powers. Thus, the forbearance letter specifically waived any regulatory requirements regarding New El Paso's use of supervisory goodwill. The "successor regulation" provision in the RCMDA recognized New El Paso's obligation to conform to existing regulatory capital requirements as well as any successor

regulations except those that had been waived by the government in the forbearance letter. The forbearance letter did not waive the government's ability to set the minimum regulatory capital level but it did waive the government's right to exclude supervisory goodwill from the definition of regulatory capital. Therefore, defendant's interpretation of the RCMDA would render the forbearance agreement illusory. As the *Franklin* court concluded:

> Thus, the Forbearance Letter and the "successor regulation" clause of the Dividend Agreement can be read in harmony as a contractual commitment by the Government permitting plaintiffs to count supervisory goodwill as amortizable regulatory capital for 25 years, regardless of any regulatory changes during that time, while preserving the Government's prerogative to change, by regulation, the minimum level of regulatory capital plaintiffs would be required to maintain ....

53 Fed.Cl. at 716.

In *Admiral*, 54 Fed.Cl. at 256-258, the court also rejected the argument that various provisions in the RCMA shifted the risk of regulatory change. As with the RCMDA in this case, the government had relied on a provision stating that "[a]ll references to regulations of the Board or the FSLIC used in this Agreement shall include any successor regulation thereto, it being expressly understood that ... such amendments may increase or decrease the Acquiror's obligation under this Agreement." *Id.* at 256. The forbearance letter issued in that case was also identical to El Paso's forbearance letter. *Id.* at 257

("This letter does not ... constitute forbearance or waiver by the Board or the FSLIC with respect to any regulatory or other requirements other than those encompassed within the preceding paragraphs."). After reviewing the forbearance letter, the court held that the successor regulation provision "should not be interpreted as exposing Admiral to the risk of sweeping changes in the bargained for method by which capital is accounted for by the FHLBB." *Id.*

The Court of Federal Claims has consistently held that successor regulation clauses do not trump the bargained for forbearances granted to the thrifts. *Sterling*, 53 Fed.Cl. at 614 ("[T]he successor regulation clause does not in any way purport to alter *Defendant's obligation* to allow Plaintiff to count goodwill ... toward regulatory goodwill and amortize it over 12 years."); *Admiral*, 54 Fed.Cl. at 256 ("Given our understanding that the regulatory forbearances affecting supervisory goodwill were bargained for exchanges, we cannot accept the argument that Admiral also bargained away any ability to enforce these promises."); *Globe Savs.*, 55 Fed.Cl. at 260-263; *Hometown*, 53 Fed.Cl. at 336-337; *Franklin*, 53 Fed.Cl. at 711-716; *S. Cal. Fed. Sav. & Loan Assn v. United States*, 52 Fed.Cl. 531, 545-547 (2002) (*SoCal*). Defendant's attempts to distinguish the facts of this case from these previous decisions are unconvincing and are without merit.

VII. Privity

A. Hughes

In order to have standing to enforce a contract

against the government, a plaintiff must have privity of contract. *Erickson Air Crane Co. v. United States*, 731 F.2d 810, 813 (Fed.Cir.1984) ("The government consents to be sued only by those with whom it has privity of contract ...."). If Hughes was a signatory to the contractual documents, he would have standing to bring a direct suit against the government. *Castle*, 301 F.3d at 1329. Plaintiff may also establish privity of contract through an implied-in-fact contract with the United States. *Maher v. United States*, 314 F.3d 600, 603 n. 1 (Fed.Cir.2002); *Bluebonnet Sav. Bank, F.S.B. v. United States*, 43 Fed.Cl. 69, 74 (1999) ("It is also of no moment that CFSB and Mr. Fail are shareholders, so long as the government breached duties owed them personally, and independently, of their status as shareholders."); *rev'd on other grounds*, 266 F.3d 1348 (Fed.Cir.2001).

According to defendant, the documents demonstrate that Hughes is simply a shareholder plaintiff who is neither a direct party nor a third-party beneficiary. *Glass v. United States*, 258 F.3d 1349 (Fed.Cir.2001). In *Glass*, the plaintiffs were the principal shareholders of the acquiring institution who also signed an RCMA personally obligating them to contribute capital to maintain its capital level. The Court of Federal Claims held that the "documentary evidence shows, however, that individually the four private plaintiffs did not contract for the regulatory treatment of goodwill arising from the acquisition; ...." 44 Fed.Cl. 73, 79 (1999). In support of its argument concerning Hughes, defendant also relies upon *FDIC ex rel. Karnes County Sav. and Loan Assn v. United States*, 52 Fed.Cl. 503 (2002), *aff d*, 342 F.3d 1313 (Fed.Cir.2003). The court found that investor

plaintiffs in Karnes, a failed savings and loan, were not in privity with the government because they were not signatories to the documents underlying the transaction. *Karnes*, 52 Fed.Cl. at 507. Instead, "the letters were from the CEO of Karnes, who stated repeatedly that he was acting on behalf of the New Association." *Id.* Therefore, the Federal Circuit held that "the regulators undoubtedly were aware that the Lees were supplying the money that would be used to rehabilitate Karnes. Neither that knowledge, the supplying of the new capital, or the Lees' position as stockholders in Karnes, made them parties to those arrangements." *Karnes*, 342 F.3d at 1319.

The government asserts that Hughes was not a party to any contract regarding New El Paso's treatment of supervisory goodwill. Defendant points to the alleged contract documents and claims that none of them involve Hughes in his individual capacity. According to defendant's argument, the fact that Hughes dealt with the FHLBB in his capacity as president of El Paso does not mean that he was directly injured. For example, defendant notes that El Paso is listed as the applicant on the H-(e)1 acquisition application and Hughes signed the application as president of El Paso. Def.'s App. at 55. In the application, it states that "El Paso Holding Corporation, a Delaware corporation {`Applicant'), hereby requests approval ... to acquire control of El Paso Savings and Loan Association ...." Def.'s App. at 60. The application provides that the "Applicant will be highly capitalized with Assets contributed by corporations and partnerships controlled by Mr. Hughes.... In addition, after the proposed acquisition of El Paso Savings, Mr. Hughes will serve as a

management official of the Applicant and as Chairman of El Paso Savings." Def's App. at 76. According to the Supervisory Agent's digest, in consideration for El Paso's purchase of the thrift's stock, Hughes "will contribute partnerships and corporations he controls to capitalize EPHC with certain parcels of real estate .... Immediately thereafter, EPHC will contribute these assets ... to El Paso Savings." Pls.' Ex. 7. In addition, the other documents referred to by plaintiffs, such as the amendments to the application and the RCMDA were only signed by Hughes in his capacity as president of El Paso. Furthermore, the alleged acceptance contained in the approval letter was sent to Hughes in his capacity as president of El Paso. Therefore, defendant argues that Hughes was a mere shareholder who infused capital into the thrift and served as a management offici.al.[8] Defendant also contends that the correspondence with the FHLBB regarding the treatment of supervisory goodwill was by an attorney representing Hughes Interests, an investment firm, instead of Hughes individually.

In *Bank of Am., F.S.B. v. United States*, the court held that investors in a holding company lacked the requisite privity because "the investors, in their dealings with the Bank Board, were not speaking for themselves but rather for their wholly owned corporation, HFH--a separate jural entity." 55 Fed.Cl. 670, 677 (2003). The plaintiffs had argued that they negotiated with the government, provided

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[8] Hughes owns 55% of the outstanding shares of El Paso. His two children own 20% each, and Mr. Scott Gregson owns 5%.

funding to recapitalize the thrift, and promised to maintain the thrift's net worth. However, the only obligation contained in the Bank Board's resolution regarding the individual plaintiffs was that they agreed in writing to follow the regulatory requirements regarding conflict of interest and transactions with holding companies. The court also found that the investor plaintiffs' personal guarantees to infuse additional capital as necessary were subsumed by the holding company's promise to do the same. Id. ("Had the investors been regarded as contracting parties in their own right, the routing of their personal guarantees, through HFH would have been unnecessary."). In response to the plaintiffs' reliance on certain cases for the principle that investors in a bank holding company who provide financial guarantees in support of a *Winstar*-related transaction are contracting parties, the court held:

> What these cases demonstrate is that in order for a shareholder to be considered a party to the underlying transaction, the shareholder's participation not only must be essential to the transaction, but also must be acknowledged in the form of a written promise, sought by and made directly to the government, that is formally recognized to constitute a part of the parties' overall undertaking.

Id. (Footnote omitted).

In *Franklin*, 53 Fed.Cl. at 717-18, the court found that investors in Franklin Financial, a holding company, were in privity with the Bank Board because the approval letter set forth obligations that they had to fulfill in their individual capacities. In

addition to cash paid by the shareholders, the holding company infused $4.5 million provided by a bank loan. The shareholders were required to personally guarantee payment of the holding company's $4.5 million loan to acquire the thrift's stock. The shareholders signed a "Shareholder Agreement to Service Holding Company Debt" obligating them to pay an amount equal to their pro rata interests in the holding company if the dividends paid by the new thrift to Franklin Financial were not enough to satisfy the debt. The approval letter also required the shareholders and the holding company to agree, in writing, to infuse additional capital to the thrift to ensure that it complied with the minimum capital requirements. Therefore, the court held that "the goodwill contract imposed duties on the individual shareholders, and the holding company they owned, for which the shareholders were personally liable." *Id.* at 718. In *SoCal*, the court held that investors in a holding company had standing because they had signed documents, incorporated into the assistance agreement by an integration clause, obligating them to infuse additional capital to maintain the thrift's capital requirements. 52 Fed.Cl. at 534-36. Although the plaintiffs had not signed the Assistance Agreement, they were parties to the RCMA guaranteeing that they would personally infuse an additional $5 million into the thrift if its capital fell below a certain level.

Hughes contends that he negotiated directly with the government, whereby, in exchange for certain regulatory forbearances he agreed to acquire El Paso Federal by purchasing subdebt, providing property which he personally guaranteed would provide

income to the thrift and executing a promissory note for the $10 million in Series A subordinated notes. In an Agreement of Obligation dated May 27, 1988, signed by Hughes individually and the FHLBB, it provided:

> In connection with the supervisory conversion application filed by Alfred D. Hughes and El Paso Holding Company to acquire El Paso Savings Association ("Obligee"), Alfred D. Hughes ("Obligor") has agreed to contribute to Obligee his interests in twelve (12) federally subsidized low income apartments ....
>
> 1. Obligor agrees to undertake the following obligation:
>
> A. For each of the next ten (10) fiscal years of the Obligee commencing with the fiscal year 1988, Obligor guarantees that the Combined Cash Flow from the properties shall not be less than One Million Dollars ($1,000,000) per fiscal year.
>
> B. Obligor agrees to provide management services for the Properties during such time as the Obligor owns the Properties at rates currently authorized by the respective housing authorities. In the event that the FHLBB removes the Obligor from the management of any Property or Properties (i) the obligations of the Obligor hereunder as to each respective Property or Properties shall cease; and (ii) the Obligor, Obligee and the Supervisory Agent of the FHLBB shall mutually reduce the Combined Cash Flow to reflect the cessation of Obligor's obligation as to each respective Property or Properties.

> 7. To the extent necessary to insure compliance of Obligor with the Obligations stated in paragraph 1 above, the FHLBB shall have the right but not the obligation to enforce the Obligor's Obligations hereunder on behalf of the Obligee. The FHLBB joins in this Agreement of Obligation for the sole purpose of acknowledging its enforcement right and for no other purpose whatsoever and by its execution hereof assumes no liabilities or obligations of the Obligee hereunder.

Pls.' App. at A229. Therefore, the document signed by both Hughes and the FHLBB specifically referred to Hughes as an acquiror. In addition, this agreement personally obligated him, above and beyond the obligations of El Paso, to ensure that these properties generated $10 million in revenue for the thrift. The agreement acknowledged that Hughes was bound to the thrift and the FHLBB by this promise and that the FHLBB could take action to enforce the guarantee. The government's internal memoranda confirm its understanding of Hughes' personal obligation. The Supervisory Agent's digest stated that "in connection with the supervisory conversion application filed by EPHC, the controlling stockholder of EPHC, Alfred Hughes, has agreed to contribute his interests in 12 federally subsidized low income apartments mentioned above." Pls.' Ex. 7. The digest also acknowledged that "in order to provide assurance of the creditworthiness of these properties to the [FHLB-Dallas], Mr. Hughes has agreed to execute a guarantee that the cash flow from these properties shall not be less than $1,000,000 per fiscal year." Pls.' Ex. 7. Thus, the government in reviewing the application, required Hughes to personally guarantee a certain amount of

cash flow from the properties and provide management services in exchange for granting the requested forbearances.

In addition, the promissory note personally obligated Hughes to repurchase the subdebt from the Steiner Partnerships and demonstrates that he was a party to the goodwill contract. On March 10, 1988, a letter to OGC describing Amendment No. 2 to the 11401 application provided that "El Paso Federal will issue $11.5 million of twelve year subordinated debentures as part of its voluntary supervision conversion and acquisition by El Paso Holding." Pls.' App. at A251. According to the amendment "Alfred D. Hughes, shall individually purchase $1.5 million ($1,500,000) Series B 10.00% Subordinated Note of El Paso Federal." Pls.' App. at A251. The May 1988 OGC memoranda confirms that the Steiner Partnerships will "purchase 100,000 shares of the Series A subordinated debt for an aggregate purchase price of $10,000,000 in cash." Pls.' Ex. 9. In the May 11, 1988 internal FHLB-Dallas memoranda, the Supervisory Agent stated that as "the proposed debt issuance meets all of the criteria of Section 563.8-1 of the Insurance Regulations, we have no objection to the inclusion of the proceeds from this issuance in regulatory capital and therefore recommend approval of the application ...." Pls.' Ex. 25. Specifically, the Supervisory Agent noted that the "net cash proceeds from the sale of the notes will be utilized to strengthen the regulatory capital position of El Paso Federal in connection with the voluntary supervisory conversion ...." Pls.' Ex. 25. The FHLBB approval letter referred to issuance of the subdebt by requiring El Paso to get approval "to include in the New Institution's Regulatory Capital

the proposed $11.5 million worth of subordinated debentures to be issued in connection with the transaction...." Pls.' Ex. 4.

The Series A subordinated notes issued by New El Paso to the Steiner Partnerships were non-voting twelve year notes with an interest rate of 9.2%. In the event of default, the debenture note holders could demand full repayment unless the payment would result in a failure by New El Paso to meet minimum regulatory capital requirements. Pls.' Ex. 9. The subordinated notes had "a minimum maturity of twelve years from issuance with interest payable quarterly." Pls.' Ex. 25. The promissory note signed by Hughes provided that he agreed to pay $10 million "with interest thereon from date hereof until maturity at the rate of Nine and two-tenths percent (9.2%) per annum; interest payable at the rate of 9.2% per annum in four equal installments on the first business day of January, April, July, and October in each year, and accruing at the rate of .72% per annum until maturity." Pls.' App. at A312. Additionally, the promissory note provided that "upon default in the punctual payment of this note or any part thereof, principal or interest, as the same shall become due and payable, the entire indebtedness secured by the hereinafter lien shall be matured ...." Pls.' App. at A313. The promissory note was a personal guarantee on the subordinated notes obligating Hughes individually to pay the $10 million owed to the Steiner Partnerships. *See Holland v. United States*, 57 Fed.Cl. 540 (2003) (holding that a put agreement by the principal owners of the acquiring institution with the purchasers of the subordinated notes was a personal guarantee).

Additionally, Hughes points to various correspondence and government memoranda summarizing his involvement in early negotiations. In a July 23, 1987 letter from the lawyer for Hughes Interests to FHLB-Dallas, it stated that "on behalf of our client, Hughes Interests, please find enclosed a draft of the proposed Agreement and Plan of Merger and Supervisory Conversion.... We would ask that you permit El Paso Federal to enter into this Agreement and Plan of Merger and Supervisory Conversion with Hughes Interests." Pls.' Ex. 13. Plaintiff also refers to a subsequent July 24, 1987 meeting attended by the attorney for Hughes Interests, the Managing Director of Hughes Interests, and the Supervisory Agent to "discuss recapitalization (a noncash capital contribution totaling $50 million by Mr. Alfred Hughes)." Pls.' Ex. 14. An internal FHLB-Dallas memorandum describing the meeting stated that El Paso Federal "has located an investor, Hughes Interests, a diversified investment firm based in Austin, Texas. The transaction involves a $50 million noncash capital contribution." Pls.' Ex. 15. Thus, the contemporaneous documents demonstrate the government's contractual intent with respect to the personal guarantees made by Hughes in his individual capacity. *See also Westfed Holdings, Inc. v. United States*, 52 Fed.Cl. 135, 145 (2002) ("A shareholder of a thrift, who is a party to a contract for regulatory treatment of the thrift may sue to enforce the contract, notwithstanding that the contract's promises are nominally made to the thrift rather than the shareholder.").

B. El Paso

Defendant argues that El Paso was not a contracting party because the forbearance letter was addressed to El Paso Federal and not El Paso. Therefore, if El Paso's H-(e)1 application is held to be an offer, the forbearance letter cannot be an acceptance of that offer because it was directed to a separate party. Instead, the government contends El Paso Federal is the only party in privity with the forbearance promise. Plaintiffs argue that the parties contracted for regulatory forbearances to be issued to the thrift in exchange for El Paso agreeing to acquire control of the thrift.

As discussed earlier, the forbearance letter is part of the overall contract between plaintiffs and the FHLBB regarding El Paso's acquisition and supervisory conversion of El Paso Federal. The FHLBB approval letter explicitly recognizes El Paso as an applicant for approval of the acquisition of the failing thrift through its subsidiary, New El Paso. Pls.' Ex. 4. ("We have also completed our review of the applications filed by the Acquirors and the New Institution ... for approval of the Acquiror's acquisition of control of the New Institution, and of the Old Institution by merger ...."). The 1-1401 application, filed with FSLIC to obtain control of El Paso Federal, was plaintiffs' offer. The government's acceptance, contained in the FHLBB approval and forbearance letters, set forth several obligations on the part of El Paso and the FHLBB. First, it required El Paso to purchase common stock in exchange for contributing certain parcels of real estate. Second, it required the FHLBB to enter into a forbearance agreement with El Paso Federal.

Thus, the approval letter authorizing FHLBB to issue such a forbearance letter reflects the reciprocal obligations contracted for by both parties. El Paso also acknowledged its obligation to maintain regulatory capital and infuse additional capital as necessary. Def.'s App. at 207, RCMDA, § II. In *Home Sav. of Am., F.S.B. v. United States*, 51 Fed.Cl. 487 (2002), the court held that the holding company, H.F. Ahmanson & Co., was in privity with the government because it had negotiated directly with the regulators to acquire the target banks through its subsidiary and promised to maintain the net worth of its subsidiary after the acquisition. As such, the holding company "does not merely have shareholder standing. It was an essential participant in each of these acquisition transactions." Id. at 499. Having contracted for the regulatory forbearances to be issued to the thrift and agreeing to the RCMDA, El Paso has standing to enforce the government's promise regarding New El Paso's regulatory forbearances.

Plaintiffs' argument is supported by the documentary evidence referring to El Paso's request for the regulatory forbearances. As stated in Article 8.07 of the Merger Plan entered into by El Paso, Hughes and El Paso Federal, the transaction is conditioned on the approval of the requested forbearances. The request for forbearances is included in the H-(e)1 application. In the ORPOS executive summary, it notes that "*EPHC has requested the following forbearances* in connection with this transaction; ... amortization of goodwill arising from the purchase accounting, for regulatory purposes, by use of the straight line method over a twenty five (25) year period." Pls.' Ex. 8 (emphasis

added). In the May 1988 OGC memorandum, it provides that ORPOS has approved six forbearances, including "for purposes of reporting to the Board, the value of any goodwill resulting from the application of purchase accounting in accounting for the acquisition may be amortized by *El Paso Holding Corporation* over a 25 year period by the straight line method." Pls.' Ex. 9 (emphasis added).

Finally, the Federal Circuit recently held that a FHLBB's forbearance letter issued to a thrift constituted a counteroffer to the holding company's application to acquire the thrift. *First Commerce*, 335 F.3d at 1381-82. The Federal Circuit did not look favorably upon the claim that the forbearance letter could not be a counteroffer because it was addressed to the thrift and not the holding company, remarking "treating the FHLBB's forbearance letter as a counteroffer fits the transaction neatly into the mold of a unilateral contract, in which the government promised favorable accounting treatment in exchange for First Commerce's performance of acquiring Mutual Federal." 335 F.3d at 1382 n. 5. Specifically, the Circuit noted that "[e]ven if we ignore the ample references to First Commerce in the forbearance letter, we cannot ignore the government's brief to this court, which states, `the FHLBB also issued a letter granting FCC several standard forbearances....'" 335 F.3d at 1382. Similarly, the forbearance letter issued in this case states that the forbearances are being granted "in connection with the approval by the [FHLBB] of the voluntary supervisory conversion of [El Paso Federal] to a state-chartered stock association and merger of El Paso with and into New El Paso ...." Pls.' Ex. 5. Because El Paso's application to acquire

El Paso Federal, FHLBB's approval letter, the forbearance letter, and the RCMDA are part of the contract, it is clear that El Paso is in privity with the government.

VIII. Damages

Plaintiffs assert that they are entitled to restitution damages in the amount of $46.5 million, which includes the $35 million in real property and $11.5 million in cash contributed to the thrift. In support of their restitution theory, plaintiffs rely upon *Landmark Land Co. v. United States*, 46 Fed.Cl. 261, 267 (2000) (awarding plaintiffs restitution for the value of cash and real property contributed to the thrift), *aff'd in part and rev'd in part on other grounds*, 256 F.3d 1365 (Fed.Cir.2001). Plaintiffs contend that the appraised value of the amount contributed is undisputed. However, defendant now disputes the true value of both the cash and real property. The government argues that the $46.5 million is merely the agreed upon equity amount and not the true market value of the contribution made by the plaintiffs. The government contends that it is prepared to put forth evidence that the appraisals are not reliable and that plaintiffs' retrospective appraisals are flawed. Defendant also disputes plaintiffs' claim to restitution for $11.5 million in cash contributions. Because a genuine dispute of material fact exists regarding the exact value of the cash and real properties contributed by plaintiffs, summary judgment on the amount of damages is inappropriate and more suited for trial.

CONCLUSION

Accordingly, it is **ORDERED:**

(1) Plaintiffs' Motion for Summary Judgment filed March 22, 1991 insofar as it seeks liability for breach of contract is **GRANTED**;

(2) Plaintiffs' Motion for Entry of Judgment on Plaintiffs' Unopposed Motion for Summary Judgment filed February 18, 2000 is **DENIED AS MOOT**;

(3) Defendant's Cross-Motion for Summary Judgment filed October 10, 2000, insofar as its seeks summary judgment on liability for breach of contract is **DENIED**;

(4) The parties are directed to consult and prepare a Status Report(s) to be filed no later than November 24, 2003, proposing the further proceedings required in order to resolve the remaining issues in this matter.

UNITED STATES COURT OF FEDERAL CLAIMS

No. 90-878C

Alfred D. HUGHES

and

El Paso Holding Corporation,

Plaintiffs,

v.

The UNITED STATES,

Defendant.

June 9, 2006

OPINION

MEROW, Senior Judge.

This is a *Winstar*-related case. *See United States v. Winstar Corp.*, 518 U.S. 839, 116 S.Ct. 2432, 135 L.Ed.2d 964 (1996). Rising interest rates in the 1980s led to the insolvency of many savings and loan associations also known as thrifts. To attract deposits, thrifts had been paying interest at rates that far exceeded their income stream from mortgage agreements that had been previously entered into at lower rates. *Castle v. United States*, 301 F.3d 1328, 1332 (Fed.Cir.2002). Liabilities of many of these thrifts exceeded their assets by millions of dollars. Between 1981 and 1983, more

than four hundred thrifts declared bankruptcy. Many more were in precarious financial straits. The insurance fund of the Federal Savings and Loan Insurance Corporation ("FSLIC"), the agency then charged with insuring deposits, simply did not have the funds to pay insured depositors. *Winstar*, 518 U.S. at 846-47, 116 S.Ct. 2432 (noting government estimates of some $15.8 billion to close all insolvent thrifts).

The Federal Home Loan Bank Board ("FHLBB" or "Bank Board"), which regulated federal savings and loans, encouraged healthy thrifts and outside investors to purchase insolvent thrifts. *Winstar*, 518 U.S. at 847, 116 S.Ct. 2432; *Franklin Fed. Sav. Bank v. United States*, 431 F.3d 1360, 1362 (Fed.Cir.2005). Transaction structures varied, but the basic idea was that private parties (typically well-managed and financially strong thrifts) proposed to acquired deeply troubled thrifts and persevere thereafter until the economy, particularly the real estate market, improved, and profits could be received on a greater asset base. By this approach, the government saved the cost of holding and liquidating insolvent thrifts and hoped to avoid the billions of dollars estimated to be required to pay off insured depositors.

Some transactions were "unassisted" in that regulators merely approved an acquisition. Others, representing the bulk of the litigation in this court, were "assisted" in that following sometimes extensive negotiations, regulators provided financial and regulatory incentives, cash or other consideration to induce acquisition proposals. Incentives included recognizing regulatory goodwill

also known as supervisory goodwill.[1] *Home Sav. of Am. v. United States*, 399 F.3d 1341, 1348-49 (Fed.Cir.2005) (finding holding company was party to a "larger transaction" with standing to sue for breach of government's promise of certain accounting treatment for goodwill). Under federal regulations, the difference between a thrift's assets and liabilities, its regulatory capital, was required to be positive by a certain percentage--here generally three percent. For example, a thrift with assets of $110 million and liabilities of $100 million would have ten percent regulatory capital.

Regulatory capital was the lifeblood of a thrift. Lending restrictions, growth and, indeed, ability to open or remain open for business depended upon maintaining the required level of regulatory capital. Therefore, not surprisingly, the definitions and components of regulatory capital were critical. In many acquisitions, including the instant one, the FHLBB agreed to allow the negative net worth of the acquired thrift to "count" toward required regulatory capital, amortized here, over twenty-five years. *Winstar*, 518 U.S. at 849-50, 116 S.Ct. 2432; *Home Sav. of Am.*, 399 F.3d at 1344-45; *Landmark Land Co., Inc. v. FDIC*, 256 F.3d 1365, 1370 (Fed.Cir.2001). Indeed, the Federal Circuit observed in *Landmark*, this forbearance was the "primary inducement that the FSLIC offered potential purchasers." 256 F.3d at 1370. The inclusion of this negative sum in regulatory capital is also referred to

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[1] "Supervisory goodwill is the excess of the purchase price paid for a thrift over the fair value of all identifiable assets acquired." *Home Sav. of Am.*, 399 F.3d at 1349 n. 1 (citing *Winstar*, 518 U.S. at 848-49, 116 S.Ct. 2432).

as "purchase accounting." In some cases, the government provided additional incentives--consideration in the form of capital credits that acquirers were permitted to apply to regulatory capital requirements. *Winstar*, 518 U.S. at 853, 116 S.Ct. 2432. In others, regulators agreed to forbear from enforcing a thrift's regulatory capital requirements for a specified period of time. *See Hometown Fin. Inc. v. United States*, 409 F.3d 1360, 1367 (Fed.Cir.2005); *Cal. Fed. Bank v. United States*, 245 F.3d 1342, 1345 (Fed.Cir.2001). And, in some transactions, significant cash was paid by the government into the thrift being acquired.

As the Supreme Court affirmed in *Winstar*, subsequent legislation eliminating previously agreed-upon supervisory goodwill, was a breach of contract. *Winstar*, 518 U.S. at 870, 116 S.Ct. 2432 ("When the law as to capital requirements changed ... the Government ... became liable for breach. We accept the Federal Circuit's conclusion that the Government breached these contracts when, pursuant to the new regulatory capital requirements imposed by FIRREA, ... the federal regulatory agencies limited the use of supervisory goodwill ..."). Contracts between the acquirers and the government have been found to exist in many acquisitions; in others, approvals have been found to be regulatory not contractual. Contract terms and documents have varied widely. Generally, however, contracts have been found in several documents as well as negotiations and correspondence between private parties and the government.

Following a July 24, 1987 meeting with federal regulators, representatives of El Paso Federal (a

troubled thrift) and plaintiffs' counsel, on August 13, 1987, Alfred J. Hughes ("Hughes"), personally, and El Paso Holding Company ("Holding Company") conditionally agreed to acquire the troubled thrift. In the Agreement and Plan of Merger and Supervisory Conversion (hereinafter "Merger Agreement"), Hughes and the Holding Company proposed to acquire El Paso Federal in exchange for contributions of 14 parcels of real property valued at $47.3 million (net of debt) and $11.5 million.[2] "On or before the Effective Date, **Hughes will cause** partnerships and corporations controlled by Hughes to capitalize [the Holding Company] with certain parcels of real estate ... currently owned by such partnerships and corporations with a [FHLBB] R Memorandum # 41c net appraisal value (after debt) of $47.3 million." (PX 190 at SF1458 (emphasis added).)

El Paso Federal would then convert from a mutual savings and loan association to a state-chartered stock association. The Holding Company would acquire the stock and then merge the thrift into El Paso Savings Association ("El Paso Savings"), a Texas-chartered interim savings association owned by the Holding Company and used to facilitate the transaction. The resulting and surviving thrift would be El Paso Savings Association ("New El Paso"), a wholly-owned subsidiary of the Holding Company.

The Merger Agreement had several conditions precedent, primarily the [3]"[a]mortization of goodwill

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[2] The source of the cash evolved over time as detailed hereinafter.

[3] A mutual association is operated for the benefit of its

arising from purchase method accounting, for regulatory purposes, by use of the straight-line method over a 25 year period."[4] (*Id.* at SF 0966, 1090.) This deal could not have happened but for the goodwill forbearance. That goodwill amortization was a condition precedent to the transaction, is highly probative on the issue of the materiality or totality of the breach, discussed hereinafter. Another condition precedent was "[t]reatment for regulatory purposes of contributed assets to be valued at current market value[.]" (PX 190 at SF 1090.)

Several days later, on August 18, 1987, the Holding Company fled an H-(e)1 Applications[5] for approval of the merger (required under federal law for a holding company to acquire a thrift). (PX 190.) The Application was signed by Hughes as President of the Holding Company. (Id. at SF 0907.) In consideration of the issuance of 1,000,000 shares of stock in New El Paso to the Holding Company,

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depositors. *Dougherty v. Carver Fed. Sav. Bank*, 112 F.3d 613, 615 (2nd Cir.1996); 12 C.F.R. § 544.1 (Charters of federal mutual savings and loan associations provide that "[a]ll holders of the association's savings, demand, or other authorized accounts are members of the association..." with one vote for each $100 on deposit.).

[4] "The obligations of [Hughes and El Paso Holding] to cause the transactions contemplated hereby to be consummated shall be subject to the satisfaction on or before the Effective Date of the the following conditions.... All ... forbearances and waivers (including, without limitation, the waivers and forbearances listed on Schedule 6.01), ... shall have been entered by each regulatory authority having jurisdiction." (PX 190 at SF 0961.)

[5] H-(e)1 refers to the statutory provision under which holding companies were required to seek permission to acquire thrifts as well as to engage in other activities.

Hughes' personal obligation to infuse assets was repeated:

> Alfred D. Hughes ("Hughes"), the principal organizer of the Applicant, will cause partnerships and corporations controlled by Hughes to capitalize [the Holding Company] with certain parcels of real estate ("Assets") current (sic) owned by such partnerships and corporations. Immediately thereafter, the Applicant will contribute the Assets, with a net estimated appraisal value (after debt) of $47.3 million, to El Paso Savings. The Assets have recent appraisals which conform to Federal Home Loan Bank Board memorandum R-41(c) or will be in compliance with Federal Home Loan Mortgage Corporation or Federal National Mortgage Association-approved guidelines. Reference is made to the Business Plan attached hereto as Part II to the Application for a more detailed description of the Assets and their contribution to El Paso Savings.[6]

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[6] The parcels were described generally along with their debt and equity:

Asset	Market Value	Debt	Equity
Income producing property Apartment projects	$32.0	$14.0	$18.0
Residential-undeveloped			
Steiner Ranch	55.7	34.5	21.2

(PX 190 at SF 0917 (emphasis supplied)); *cf.* Castle, 301 F.3d at 1340 (finding individuals who signed the agreements were not personally responsible or required to cause the capital infusions).

The H-(e)1 Application proposed to use the "purchase method of accounting. The fair value of liabilities assumed in excess of the fair value of tangible and identified intangible assets acquired shall be amortized to expense over a period of over 25 years." (PX 190 at SF 0924-25.) "An integral part of this Application is the assumption that the FHLBB will act quickly on this Application and will grant certain regulatory forbearances to the Applicant as a result of its acquisition of El Paso Savings." (*Id.* at SF 0920.) The Application disclosed that Alfred Hughes owned 55% of the shares of the Holding Company and the balance was owned by his son and daughter. (*Id.* at SF 0922.) The Holding Company was a single-purpose entity created to hold the stock of the newly converted and merged El Paso Savings. Hughes, who had prior savings and loan expertise,[7] was the organizer, president, and

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Commercial Property			
Waterford Centre	25.6	17.5	8.1
	$113.3	$66.0	$47.3

(PX 190 at SF 0923 (footnote omitted)

[7] Hughes' employment history was outlined including his position with Austin Savings Association in branch acquisition and lending, as branch manager and as Vice President of Lending. He later became president of a savings association charter and developed the first major subdivision in Round Rock, Texas. He was involved in 56 separate government-

majority shareholder. (*Id.* at SF 0907 and 0917.) Included with the Application was Hughes' financial statement listing ownership in some 27 properties, 32 partnerships, corporations, and joint ventures in which he previously or currently had an interest; and short and long term obligations. (*Id.* at 1113 et seq.)

Under the Business Plan, New El Paso's viability depended on purchase accounting. "The Association will have sufficient capital [after the merger] to achieve a ratio of capital to liabilities in excess of the Association's regulatory capital requirement, which exceeds 3% of total liabilities." (*Id.* at SF 1620-21.) As El Paso Federal's negative net worth kept rising, so did the importance of this condition precedent. The intent of the Business Plan was "to return the Association to profitability through growth and higher interest spreads while managing the risk level in the current loan and investment portfolio." (*Id.* at SF 1626.) The Section 8 apartments[8] to be contributed were projected to have a positive cash flow of $1.8 million annually. (PX 190 at SF 1627.)

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related projects, owning 21 government apartment complexes, comprising some 2,200 separate living units. Through an affiliated company, he headed a 90- person team that managed those complexes. (PX 190 at SF 1108.) He was on the of Interfirst Bank-Austin, also serving on the Credit Policy Committee. In 1986, he was appointed by Texas Governor Mark White to serve on the Board of the Texas Department of Corrections (an agency with over 12,000 employees and an annual budget in excess of $500 million). He subsequently was elected chairman. (*Id.* at SF 1108-09.)

[8] The government guaranteed the rent on these apartments. Occupancy was normally at 100% with no delinquencies. WX 190 at SF 1628.)

Less than fee ownership of a portion of Steiner Ranch was disclosed. The 3,750 acres would be contributed to the thrift, and another 750 acres would be held in a joint venture with a third, but related party. (PX 190 at SF 1628.)

Amendment No. 1, filed February 3, 1988, followed "discussions between the applicant and the Appraisal Department of the [FHLB-Dallas], [and] the market value of the real estate to be contributed by applicant to [New El Paso] was adjusted to $35 million (net of outstanding debt)." (PX 272 at 4277.)

In Amendment No. 2, dated March 10, 1988, the $11.5 million originally proposed as a preferred stock purchase was amended to a purchase of subordinated debentures. (PX 289.)

El Paso Federal, the troubled thrift, had a negative net worth of about $17 million, but that number increased to over $46 million by the time the deal closed. The obvious question comes to mind is why would anyone acquire a thrift with a negative net worth of $46 million, and invest over $40 million (real estate equity of $35 million and an additional $11.5 million) to do so? The short answer is the government promised forbearances that would allow the operation and possible consolidation and implementation of efficiencies and growth until the economy, and particularly the Texas real estate market, improved at which time enhanced return on investment was anticipated. Here, unlike many Winstar cases in which the government's assistance included cash or cash equivalent contributions, no direct financial contributions were sought or obtained from the government. "It is important to note that El Paso Holding is seeking no financial

assistance from the FSLIC in connection with the proposed merger conversion, despite El Paso Federal's financial condition." (PX 1.90 at WOT 467 0372.)

On May 13, 1988, the FHLBB, approved the Application, declaring the transactions "are instituted for supervisory reasons and are necessary to prevent the probable failure of the Old Institution." (PX 338 at 2.) The Approval Letter provided that "[p]ursuant to delegated authority to approve the applications noted herein, the Secretary or an Assistant Secretary of the Board is hereby directed and authorized to issue to the New Institution a letter, effective upon the merger of the Old Institution into the New Institution concerning supervisory forbearances" ("Forbearance Letter"). (PX 338.) Approval was not conditioned upon the execution of a Regulatory Capital Maintenance/Dividend Agreement ("RCMDA") (agreement to limit dividends and to infuse capital into the acquired thrift to restore regulatory capital deficiencies). *Cf. Franklin Fed. Sav. Bank*, 431 F.3d at 1361 n. 1(Fed.Cir.2005) (FHLBB approval conditioned upon RCMDA). A Certificate of Insurance (required for the new thrift to operate) was authorized provided that the Federal Home Loan Bank of Dallas (a regional component of FHLBB) ("FHLBDallas") approved the inclusion of $11.5 million of subordinated debentures in regulatory capital, and that "certain parcels of real estate which have an aggregate net estimated appraisal value (after debt) of $35 million" be

conveyed to the new thrift.[9]

Also on May 13, 1988, the FHLBB issued the referenced Forbearance Letter to New El Paso, "directed and authorized in the Resolution, granting several forbearances including the use of supervisory goodwill to be amortized over 25 years." (PX 336.) The Forbearance Letter had several conditions. A RCMDA was not among them.

The Forbearance Letter was signed by the FHLBB's Acting Secretary, and granted six forbearances, including the use of supervisory goodwill and amortization over a 25 year period. While certain forbearances were limited to one or five years, the goodwill forbearance (Item No. 3) was not; rather amortization could be as long as 25 years.

> 1) [t]he Federal Savings and Loan Insurance Corporation ("FSLIC") will forbear, for a period not to exceed five (5) years following

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[9] Other conditions of approval were (1) the acquisition and merger occur within 60 days; (2) an opinion letter be given that the acquisition did not generate any tax liability and complied with securities laws; (3) both the acquirer and the troubled thrift agree that no adverse events had occurred since the applications; (4) copies of charters and bylaws are filed; (5) an independent accountant opines that the transaction was consummated in accordance with generally accepted accounting principles, and "specifically describes, as of the effective date of the acquisition, any intangible assets including goodwill;" and (6) resolutions of the Board of Directors of the new institution ratifying applications be provided. (PX 338.) The Forbearance Letter, a copy of which was in the file, was "directed and authorized" immediately effective upon the merger. (PX 336.) These were conditions subsequent in that if a condition was not met, then the Approval and the Forbearance Letter would be cancelled.

consummation of the acquisition ("Effective Date"), from exercising its authority under Section 561.13 of the Insurance Regulations, for any failure of El Paso to meet the net worth requirements of Section 561.13 arising solely from an increase in the contingency factor attributable to El Paso at the date of acquisition.

2) For a period not to exceed five (5) years, from the Effective Date, the FSLIC will forbear from exercising its authority under Section 563.9-8(c)(2)(i) or (ii) or (iii) (Threshold for Equity Risk Investments) of the Insurance Regulations, to allow New El Paso to exclude all investments currently in El Paso's portfolio in determining the amount available for equity risk investments.

3) For purposes of reporting to the Board, the value of any unidentifiable intangible assets resulting from accounting for the merger in accordance with the purchase method may be amortized by New El Paso over a period not to exceed twenty five (25) years by the straight line method, from the Effective Date.

4) Not later than one hundred twenty (120) days following the Effective Date, New El Paso shall submit to the Supervisory Agent an independent certified public accountant's opinion that New El Paso has accounted for this merger in accordance with generally accepted accounting principles except as herein provided by the Board, for purposes of reporting to the Board, the value any unidentifiable intangible assets resulting from the merger may be amortized by New El Paso over a period not to exceed twenty five (25) years by the straight line method.

(PX 336.) The Forbearance Letter also reduced certain liquidity determinations and terminated the Supervisory Agreement covering the acquired thrift.

Fifteen days later, on May 27, 1988, the Holding Company and FSLIC signed a RCMDA in which, "in consideration of the FSLIC approving the acquisition of control of El Paso Federal by [the Holding Company]" (which the Bank Board had already done),[10] the Holding Company, agreed to, "[a]s long as the [Holding Company] controls [New El Paso], the [Holding Company] will cause the Regulatory Capital of [New El Paso] to be maintained at a level[11] at or above the Regulatory Capital

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[10] The RCMDA recited, FSLIC was "a corporate instrumentality and agency of the United States, which is under the operating direction of the Federal Home Loan Bank Board." (PX 354 at HS100379.) In *Hansen Bancorp. v. United States*, 67 Fed.Cl. 411, 421-22 (2005) the court declined to "opine about the legal consequences of this inconsistent treatment by the two cognizant agencies," referring to two forbearance letters by two federal agencies, one of which was unqualified and absolute (in which case the government agreed to bear the risk of regulatory or statutory change), and the other qualified (in which case the acquirer may have agreed to bear the risk of such change.).

[11] Indeed, the Office of General Counsel's Memorandum to the FHLBB on this acquisition noted the recommendation of the Office of Regulatory Policy Oversight and Supervision ("ORPOS") for a "standard" RCMDA. "The `standard' agreement require[s] a holding company to agree to maintain the Association's regulatory capital at the levels required by Section 563.13 of the Insurance Regulations, and to limit the payments of dividends to an amount not to exceed 50 percent of the Association's net income from the prior year." (PX 343 at 11 (emphasis added.)); (*see also* PX 259 at 15 (memorandum from Principal Supervisory Agent George Barclay to Linda Plye, Director, Corporate Activities, Office of Regulatory Policy,

Requirement and as necessary, will infuse sufficient additional capital, in a form satisfactory to the Supervisory Agent, to effect compliance with such requirement and cure a Regulatory Capital Deficiency during the first quarter after which [New El Paso] fails to meet its Regulatory Capital Requirement." (PX 354 at 0380.) The Holding Company also agreed that it would not accept, and New El Paso would not pay, dividends in excess of fifty percent of the thrift's net income. The RCMDA did not contain an integration clause; did not incorporate any other document; and did not include Hughes as a party.

On September 9, 1988, FHLB-Dallas concluded the approval conditions had been met. Upon closing of the sundry transactions, New El Paso had regulatory capital of $46.5 million, consisting primarily of the negative net worth of the acquired thrift. (PX 446.)

Despite literally more than one hundred private acquisitions of troubled thrifts with some form of government assistance and/or forbearances, the savings and loan crisis continued. On August 9, 1989, Congress enacted the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub.L. No. 101-73, 141 Stat. 183 ("FIRREA') ostensibly to attack the causes of the crisis and restore public confidence. *Winstar*, 518 U.S. at 856, 116 S.Ct. 2432. After FIRREA and its implementing regulations, supervisory goodwill could no longer be included in computing regulatory capital. "FIRREA

Oversight and Supervision recommending approval of the acquisition subject to several conditions including a RCMDA).)

greatly reduced the amount of supervisory goodwill that could be used to meet regulatory capital requirements." *Winstar Corp. v. United States*, 64 F.3d 1531, 1545 (Fed.Cir.1995) (citing 12 U.S.C. § 1464(t)); see also 12 C.F.R. § 567.1(w) (1990) (restrictively defining the amount of supervisory goodwill that qualified for regulatory accounting). Regulators demanded substitute capital be infused into New El Paso, and because of its imputed regulatory capital deficiency, New El Paso was subject to stringent operating restrictions.

In summary, as details are related in the discussion of materiality, causation and foreseeability, *infra*, New El Paso was unable to meet FIRREA's new capital requirements. On December 1, 1989, regulators informed New El Paso that it would be out of capital compliance on December 7, 1989 and a capital restoration plan was required. (PX 660 at 0976.) New El Paso's case manager noted in February of 1990 that the thrift's "failure" to meet capital "requirements [was] largely the result of goodwill on [New El Paso's] books which equaled approximately $42,491M (sic) as of October 31, 1989." (PX 702 at 1235.) On June 11, 1990, the Office of Thrift Supervision ("OTS") informed the Holding Company that New El Paso had not been in compliance with its regulatory capital requirements since December 7, 1989. (PX 757; DX 1421.) Demand was made on the Holding Company to make up the approximately $47,407,000 capital deficiency. On July 2, 1990, the Commissioner of the Texas Savings and Loan Department placed New El Paso in a conservatorship, citing several reasons, the first of which was failure to meet federal regulatory capital

requirements.[12] (PX 763.) On August 2, 1990, OTS directed New El Paso "to immediately discontinue including supervisory goodwill in the amount of approximately $41.5 million, or in any other amount, in its core capital calculation ...." (PX 769; DX 1442.) On September 7, 1990, OTS placed New El Paso in a receivership for the same reason. (PX 785; DX 1458.) Also because of its capital deficiencies, significant operating restrictions were imposed. New El Paso was subsequently liquidated.

Liability for breach of contract established

The court previously granted plaintiffs' Motion for Summary Judgment on Liability, finding (1) the parties entered into a contract that included the government's promise that the $44 million in negative net worth of the acquired thrift, amortized over a period not to exceed twenty-five years, would count as regulatory capital; (2) both Hughes and the Holding Company were parties to that agreement; and (3) FIRREA was a breach. *See Hughes v. United States*, 58 Fed.Cl. 291, 301 (2003) ("*Hughes I*"). *Hughes I* contains findings and conclusions on contract formation, which will not be repeated here. This opinion also rejected the government's argument that the Holding Company agreed to bear the risk of regulatory change concerning supervisory goodwill. Id. at 305-07. Following the Federal Circuit's opinions in *Admiral Financial Corp. v. United States*, 378 F.3d 1336 (Fed.Cir.2004), and

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[12] Plaintiffs contend that the other reasons listed would not have supported a conservatorship and that it was the regulatory capital deficiency that prompted the State of Texas Conservatorship.

more recently *Franklin Fed. Sav. Bank v. United States*, 431 F.3d 1360 (Fed.Cir.2005), the court revisits that determination.

For damages, plaintiffs seek the return of $35 million in equity in the 14 contributed properties and $11.5 million paid to the thrift for the purchase of subordinated debentures. The government contests the recited value of these contributions and also asserts: (1) any values must be offset by the benefits conferred on plaintiffs both at the time of contracting and during the more than one year plaintiffs "got" to operate New El Paso; (2) FIRREA was not a material, substantial or total breach; and (3) New El Paso would have failed anyway; therefore, any return of the value of these contributions would be an impermissible windfall.

Hughes I found FIRREA and its implementing regulations eliminated the condition precedent to this acquisition--the supervisory forbearance in the Approval Letter. 58 Fed.Cl. at 301 ("The contractual agreement authorizing the use of purchase method accounting and its amortization over a 25 year period was breached by FIRREA.... FIRREA prevented New El Paso from using its supervisory goodwill in meeting its minimum regulatory capital requirements."). To be sure, as the Supreme Court explained in *Winstar*, regardless of contractual commitments, the government has the unfettered right to amend statutes and regulations. However, when those amendments contravene contractual commitments, the government is liable for breach and its recompense. *Winstar*, 518 U.S. at 869-70, 116 S.Ct. 2432. FIRREA breached plaintiffs' agreement with the government. In return for $35 million in

real property and $11.5 million to purchase subordinated debentures of the new thrift, plaintiffs agreed to acquire El Paso Federal, a troubled thrift. The acquisition relieved the government from having to take over and liquidate the thrift and pay off insured depositors. The material, substantial and primary consideration (indeed a condition precedent) was the long-term amortization of supervisory goodwill. As damages for the government's breach, plaintiffs seek to be returned to their pre-agreement condition--return of their initial investments of $35 million in net equity in real estate contributed and $11.5 million for purchase of subordinated debentures.

Following a seven-week trial on damages, extensive post-trial briefing including plaintiffs' initial submissions of 375 pages with a 177 pages initial response by the government, and numerous additional and supplemental submissions, after consideration, the court concludes that (1) FIRREA's breach was material, substantial and total; (2) plaintiff Hughes is entitled to the value of the required contributions as reliance or restitution damages; (3) no offsets were established; (4) no tax gross-up is warranted at this time; (5) Hughes did not agree to bear the risk that the government could unilaterally eliminate supervisory goodwill. However, following Federal Circuit precedent, the court finds the Holding Company agreed to bear the risk of regulatory change and cannot, therefore, recover damages.

Conveyance of title and valuation of the properties

The government argues that plaintiffs are not entitled to restitution/reliance damages for the value of the 14 contributed properties because plaintiffs did not "contribute" them; rather they were conveyed by related third-parties not in contractual privity with the government.[13] The government also contests the aggregate valuation of $35 million equity (net of debt) recited in contract documents, protesting that number was really not agreed-upon, and even if it were, any restitution or reliance damages for breach should be the net realizable equity ("NRE") the plaintiffs would have received from the sale of these properties (basically, sales price less costs of sale, handling costs, taxes, etc.) such that the "real" value of the $35 million in equity was (or is) $4.1 million. Also, plaintiff Hughes' contribution/purchase of $11.5 million in subordinated debentures was a paper transaction, not a value, cost, or benefit to be "returned" because of the government's breach.

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[13] In return for their conveyances, Old El Paso issued one million shares of common stock to Al Hughes, Lance Hughes, Brenda Hughes and Scott Gregson. These individuals then exchanged those shares for shares in the Holding Company. In the end, the Holding Company owned Old El Paso. The one million shares of common stock in Old El Paso were cancelled and Old El Paso merged into New El Paso. The corporate formalities should be maintained the government argues, because most of the conveyances were to have gone through the Holding Company (but many did not), having availed themselves of the corporate protections of the Holding Company, Hughes, his family and associated entities should not be allowed to pierce that corporate veil.

Plaintiff's respond that all 14 parcels were conveyed to New El Paso. Plaintiffs "caused" the conveyances, which aside from disputes concerning valuations, the government admits were made. Entities controlled by, or related to, Hughes or the Holding Company made the conveyances--details disclosed to, and acknowledged by, regulators. Hughes was contractually responsible for causing the properties to be contributed to the thrift, was required to do so and did do so. That is all that is required. Secondly, valuations in the contracting documents were informed, negotiated and agreed-upon by the government, providing the framework for the court's damage analysis, values that are independently supported by appraisal testimony.

Amendments and regulatory documents confirm that Hughes was personally responsible for the contributions, and that a negotiated equity amount was part of the deal. A January 20, 1988, FHLB-Dallas summary of the proposal from George Barclay, Principal Supervisory Agent to Linda Plye, Director, Corporate Activities, ORPOS, stated that "Alfred D. Hughes ('Hughes') the principal organizer of [the Holding Company], will contribute partnerships and corporations he controls to capitalize [the Holding Company] with certain parcels of real estate ... with a net estimated appraisal value (after debt) of $35,000,000." (DX 464 at WON989 0087.) "Equity interest," based on the "appraised value" of each of the 14 properties less debt was delineated. (*Id.*) ("The following properties are being contributed by Mr. Hughes as part of the recapitalization of El Paso Federal.")

Property	Equity Interest
Waterford Center	$ 8,100.000
Steiner Ranch	13,400,000
Twelve Section 8 Apartments	13,500,000
	35,000,000

The appraised value of the Section 8 apartments are as follows:

Springdale Apartments	$ 1,700,000
Walnut Manor Apartments	1,030,000
Mason Manor Apartments	2,735,000
New Light Apartments	3,950,000
Sir John Apartments	1,575,000
Redwood Apartments	5,000,000

Robin Square Apartments	2,700,000
Trinity Garden Apartments	2,750,000
La Hacienda Apartments	1,175,000
Palacio Real Apartments	2,690,000
Neptune Apartments	440,000
Roswell Apartments	1,170,000
	$26,915,000

(*Id.*)

Regulators were concerned about the Section 8 projects because their value depended in large measure upon government subsidy. Cognizant of Hughes' experience in managing these properties, negotiations over the value of the Section 8 properties led to Hughes' personal guarantee of annual net cash flow of $1 million, his agreement to continue to manage these properties, to limit dividends and not to sell for less than their book value:

> In connection with the supervisory conversion application filed by [the Holding Company], the controlling stockholder of [the Holding Company],

> Alfred Hughes, has agreed to contribute his interests in 12 federally subsidized low income apartments mentioned above. In order to provide assurance of the creditworthiness of these properties to the Federal Home Loan Bank of Dallas, Mr. Hughes has agreed to execute a guarantee that the cash flow from the properties shall not be less than $1,000,000 per fiscal year. Cash flow is defined as the total funds generated annually by the operation of the properties less the debt service costs.
>
> Mr. Hughes further agrees not to sell any or all of the properties for an amount less than the book value of such property or properties without the prior written consent of the Supervisory Agent.

(*Id.* at WON989 0088.) This guarantee refers to Hughes as an "Applicant."[14]

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[14] In connection with the supervisory conversion application filed by Alfred D. Hughes and El Paso Holding Company to acquire El Paso Savings Association ("Obligee"), Alfred D. Hughes ("Obligor") has agreed to contribute to Obligee his interests in twelve (12) federally subsidized low income apartments ....

> 1. Obligor agrees to undertake the following obligation:
>
> A. For each of the next ten (10) fiscal years of the Obligee commencing with the fiscal year 1988, Obligor guarantees that the Combined Cash Flow from the properties shall not be less than One Million Dollars ($1,000,000) per fiscal year.
>
> B. Obligor agrees to provide management services for the Properties during such time as the Obligor owns the Properties at rates currently authorized by the respective housing authorities. In the event that the FHLBB removes the Obligor from the management of any Property or Properties (i) the obligations of the Obligor hereunder as to

Amendment No. 2, included a change from $11.5 in preferred stock to $11.5 in purchase of subordinated debentures--$10 million were being purchased by Steiner entities and $1.5 million would be purchased by Hughes individually.[15] The

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each respective :Property or Properties shall cease; and (ii) the Obligor, Obligee and the Supervisory Agent of the FHLBB shall mutually reduce the Combined Cash Flow to reflect the cessation of Obligor's obligation as to each respective Property or Properties.

...

7. To the extent necessary to insure compliance of Obligor with the Obligations stated in paragraph 1 above, the FHLBB shall have the right but not the obligation to enforce the Obligor's Obligations hereunder on behalf of the Obligee. The FHLBB joins in this Agreement of Obligation for the sole purpose of acknowledging its enforcement right and for no other purpose whatsoever and by its execution hereof assumes no liabilities or obligations of the Obligee hereunder.

(PX 354, Tab 45 at HS100436-37.)

Hughes built 56 government-subsidized projects. After the conveyances here, he still retained 22 projects consisting of approximately 2,200 separate units. (Tr. at 1594:22-1596:35 (Hughes).

[15] In his individual capacity, Hughes would purchase $1.5 million of Series B subordinated notes issued by New El Paso. New El Paso would also issue $10 million of Series A subordinated notes to retire a portion of the related debt on the Steiner properties. According to the May 1988 internal OGC (Office of General Counsel) memoranda, "T.C. Steiner and Son, a Texas General Partnership and Steiner and Sons, Ltd. (the `Steiner Partnerships') will purchase 100,000 shares of the Series A subordinated debt for an aggregate purchase price of $10,000,000 in cash." (PX 313 at 3.) (T.C. Steiner and Son and Steiner and Son, Ltd. are controlled by Mr. Tommy C. Steiner, who had been a business partner of Hughes.) Instead of receiving $10 million cash, New El Paso paid out $10 million

Amendment also responded to ORPOS comments as to the nature of Hughes' interests in the 14 properties to be contributed.[16] The preclosing March 10, 1988 response is stark evidence of the government's initial curiosity that prompted the inquiry, and subsequent knowledge that the properties were then owned by several entities, but that Hughes was obligated to effect their contribution. Ownerships of the fourteen properties to be contributed were:

Palacio Real Apartments	Technical Properties[17]
Neptune Apartments	Technical Properties

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less than it otherwise would have paid to retire the debt on the contributed properties. In other words, the Steiner debt was $21.5 million. However, New El Paso only paid out $11.5 million. On May 27, 1988, Hughes executed a promissory note payable to Mr. Steiner for the remaining $10 million. New El Paso would loan $34.4 million to a newly formed subsidiary to develop the Steiner Ranch property. Bottom line there was full disclosure--whether setoff or cash from one pocket into another--the result is the same.

[16] "The Applicant states Mr. Alfred Hughes will cause partnerships and corporations he controls to capitalize the proposed holding company with his interest in (14) parcels of real estate. Please specify exactly what Mr. Hughes's interest is in each of the (14) parcels of real estate." (PX 289 at SF 6690.)

[17] As described in the chart of enumerated properties, Technical Properties was a general partnership with the following owners and ownership shares: Alfred D. Hughes, 26%; Patricia Hughes, 26%; Brenda Hughes Management Trust, 24%; and Lance Hughes Management Trust, 24%.

New Light Apartments	Technical Properties
Redwood Gardens	Technical Properties
Sir John Apartments	Technical Properties
Trinity Apartments	Technical Properties
Robin Square Apartments	Challenge Properties[18]
Roswell	Alfred J. Hughes
Mason Manor	Alfred J. Hughes
Springdale Gardens	Alfred J. Hughes
Walnut Manor	Alfred J. Hughes
Hacienda	Brenda Hughes Management Trust

[18] As described in the chart of enumerated properties, Challenge Properties was a general partnership of Alfred D. Hughes and Patricia Hughes with 70% and 30% ownership interests respectively.

H & G Properties, Ltd. H & G Properties, Ltd.[19]

Steiner Ranch, Ltd. Steiner Ranch, Ltd.[20]

(PX 289 at SF 6691.)

Amendment No. 3 dated March 22, 1988 responded to additional comments from ORPOS and OGC concerning ownership of the properties to be contributed. (PX 300 at WON989 1747.) In detailed candor, Mr. Hughes' pre-closing letter to Ms. Goings, of ORPOS, responded to her query concerning Steiner Ranch, and answers the government's belated complaint that the type of ownership of Parcel A was either hidden or not disclosed:

> As described in the Business Plan,[21] the two parcels of Steiner Ranch, Parcel A representing

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[19] As described in the chart of enumerated properties, H & G Properties, Ltd. was a limited partnership consisting of. Alfred D. Hughes, 74%; Brenda Hughes Management Trust, 10%; Lance Hughes Management Trust, 10%; J. Scott Gregson, 5%, and Brenlan Corporations, 1%.

[20] As described in the chart of enumerated properties, Steiner Ranch, Ltd. was a limited partnership with the following owners and ownership shares: Alfred D. Hughes, 55%; Brenda Hughes Management Trust, 20%; Lance Hughes Management Trust, 20%; and Scott Gregson, 5%.

[21] As part of the Application, Hughes and the Holding Company submitted a three-year Business Plan "to return the Association to profitability using prudent lending and deposit growth techniques" through growth including the purchase of "mortgage backed securities," "diversification of lending operations," and "branch deposit acquisitions." (Pls.' PFF 90.)

> 752 acres and Parcel B representing 3711 acres, comprise the entire Steiner Ranch holdings of the Applicant. Attached is an exhibit indicating the relative locations of each parcel. Fee title to Parcel B is to be contributed into the institution and subsequently into New Sub, while Parcel A will be contributed and held in (sic) Joint Venture. Parcel B is to be contributed to the institution and the recognized equity will serve as a component of regulatory capital. Parcel A will be contributed through the conveyance of an eighty percent partnership interest owned by the Applicant.

(PX 300 at 1748.)

ORPOS, again prior to closing of this transaction, recognized that Hughes did not own the properties being contributed, and asked about the consideration for the conveyances into the surviving thrift. Also implicit in this exchange is that Hughes was personally responsible for and was arranging for the contributions.

ORPOS COMMENT No. 3:

> Amendment No. 2 discloses that Mr. Hughes does not have 100%ownership in the (14) parcels of real estate. What consideration will be received by the individuals and trusts in exchange for this transfer of ownership? Provide evidence verifying that the ownership of the trust can be transferred.

Response: Attached please find a letter from

> Thomas Hill, Esq. which: (i) discusses the consideration to be received by the beneficiaraies (sic) of the trusts in exchange for the transfer of the real estate; and (ii) opines as to the tranferrabiliy (sic) of the ownership of the trust.

(PX 300 at WON989 1778.) The referenced letter from counsel opines that Hughes, and his wife (and co-trustee), Patricia Henderson Hughes, had the authority to transfer property to their children, the beneficiaries of the Trust, who in turn, both being adults, could then convey to the Holding Company in return for stock in the Holding Company. (*Id.* at WON989 1779.) The disclosure of consideration assuages any concerns that the transferors were not compensated or that plaintiff(s) would reap a windfall. Hughes had the capability and apparently did "cause" the contribution of said properties to the thrift.

Amendment No. 3 also described Hughes as causing the contributions of real
estate.

At the Acquisition Date, all of the following events will occur:

> 1. Partnerships and corporations controlled by Alfred D. Hughes will contribute the Steiner Ranch with the Related Debt to El Paso Holding Corporation (`El Paso Holding'). Immediately thereafter, El Paso Holding will convey Steiner Ranch to El Paso Federal as part of the consideration paid for the stock of El Paso Federal by El Paso Holding.

(PX 300 at WON989 1783.)

There is no question that the properties were contributed. There is no suggestion of any windfall, nor does the government complain that it may have to pay twice. Given that the contributions were made in the late `80s, passage of time obviates that concern. Arguing plaintiffs did not hold title to all the properties, the government seeks to foreclose any damages in this case despite the fact that the government breached its promise. The court declines to reach such a result. *See Restatement (Second) of Contracts* § 346, cmt. a (1981) ("Every breach of contract gives the injured party a right to damages against the party in breach" unless "[t]he parties ... by agreement vary the rules"); 3 *Farnsworth, Contracts* § 12.8, p. 185 (1990) ("The award of damages is the common form of relief for breach of contract. Virtually any breach gives the injured party a claim for damages"); *Winstar*, 518 U.S. 839, 886, 116 S.Ct. 2432, 135 L.Ed.2d 964 (1996).

That the property title holders other than Hughes have not sought restitution is understandable. Lacking obligatory privity, they cannot recover their "contributions." In *Castle*, 301 F.3d at 1338, the Federal Circuit denied individuals Harlan and Castle restitutionary damages of the value of contributions made by third parties because neither Harlan nor Castle were contractually required to make those infusions. "The documents comprising the alleged contract ... contain no promise by Castle and Harlan to recapitalize [the thriftl in their individual capacities." 301 F.3d at 1340.

John K. Castle and Leonard M. Harlan as

> individuals will form a new entity [ ] into which the present [association] [1 will be merged. New Western Empire will issue up to $ 10 million of perpetual Senior Preferred Stock to an investor group *organized by Castle Harlan, Inc.* in order to recapitalize the association ....

Id. "[Under the contract documents] neither plaintiff promised to be individually responsible for ensuring that [the thrift] was adequately capitalized." Id. In contrast, here Hughes was contractually required to and did obtain the infusion of the 14 properties. "Alfred D. Hughes ('Hughes'), the principal organizer of the Applicant, **will cause partnerships and corporations controlled by Hughes to capitalize [the Holding Company] with certain parcels of real estate ('Assets') current (sic) owned by such partnerships and corporations.**" (PX 190 at SF 1458 (emphasis added).)

Plaintiffs' ability to receive money-back reliance/restitution is unaffected by the source of the consideration where the non-breaching party is required under the contract to make the contributions and they are made. "It is inconsequential that Westfed chose to borrow the funds from investors to acquire [the troubled thrift's] shares rather than use its own money." *Westfed Holdings, Inc. v. United States*, 407 F.3d 1352, 1368 (Fed.Cir.2005). No claims of financial recompense were suggested, and none would be expected given the interlocking ownerships. Moreover, plaintiffs are clearly in privity of contract with defendant and to the extent any former owner of contributed property were to seek a share of the proceeds of this litigation,

this would be a matter between the plaintiffs and the former property owner and not relevant to the present litigation. This court would not have jurisdiction over such a claim. *Rolls-Royce, Ltd. v. United States*, 176 Ct.Cl. 694, 698-99, 364 F.2d 415, 418 (1966).

The contributed properties

The following description of the contributed properties underlies the court's findings of their value, plaintiff(s)' ability to cause their contribution, and the government's defenses of nondisclosure, mismanagement, offset and windfall.

1. Waterford Centre

In 1987, Waterford Centre, an approximately 40 acre commercial parcel located 7 miles northwest of Austin, Texas, consisted of two parcels. The first was 33 acres including nine commercial lots. The second parcel of 7 acres was leased for 60 years to Healthcare Austin, which planned to build a hospital on the site. The lease included a purchase option that made it economically advantageous to purchase the property in ten years. Excluded was a 2.2 acre parcel previously sold in 1986 to Austin Beverly Heritage ("ABH"), a hotel developer.

The Waterford Centre parcel had been partially developed, and as of May of 1988, approximately $17 million had been spent on development. The appraisal submitted to the regulators with the Application valued Waterford Centre at $25.6 million consisting of (1) the value of the fee simple interest in the 33 acre tract ($12.6 million) and (2)

the residuary interest of the 7 acre tract leased to HCI ($13 million). (PX 1, 2.) The appraisal conformed to FHLBB appraisal regulations, including FHLBB Memorandum R-41c.

Regulators also valued Waterford Centre at $25.6 million. (PX 55; PX 259.) Lewis, plaintiffs' expert appraiser, performed a retrospective appraisal of the Waterford Centre, opining it was worth approximately $24 million as of December 1987 when the parties met and agreed on valuations. (Tr. at 4134:3-10.) Mr. Hendricks, the government's expert witness, did not dispute that val ation. (Tr. at 6969:2-21.)

2. Section 8 Apartments

Contributed properties also included twelve Section 8 apartment projects with government-guaranteed rents. (Tr. at 1657:6-25.) Tenants pay a percentage of that rental amount, depending on their income level; the government pays for the rest. (Tr. at 1657:6-1658:6.) These contracts had 15 year terms and renewal was generally *pro forma*. (Tr. at 6480:22-6481 and Tr. at 1659:5- 1660:15.)

These twelve projects had annual cash flow of more than $5 million. (Tr. at 569:18-22; Tr. at 1660:16-20; PX 232-233.) In considering plaintiffs' application, regulators classified Hughes' management as "excellent," "appears very competent and well organized" and required Hughes' company continue to manage these apartments. (PX 84 at 1; PX 353.) The appraisals Hughes submitted with his application in 1987 valued these properties at approximately $32 million. (PX 14-16, 28-46.) Regulators at the time of this transaction valued the

12 apartments at $26.915 million. In 1984, Hughes received an offer from one of the nation's largest developers of low-income housing to purchase all 12 apartments for approximately $46 million. (PX 913.) Mr. Lewis, plaintiffs' expert witness, appraised these properties at approximately $25 million. (Tr. at 4140:15-4155:21; 4165:14-4171:11.)

3. Steiner Ranch

Steiner Ranch was 4,500 acres located in hill country 15 miles west of Austin, Texas. There was considerable testimony about its value as mixed-use, primarily subdivision development. The ranch had several miles of lake frontage on Lake Austin and other lots had lake views. Fast-forwarding from the acquisition, FIRREA's breach, and the ultimate take-over of El Paso Saving, it is noted, but not considered with respect to valuation in this matter, that subsequent development of ranch property flourished with $500,000 homes being constructed.

Specifically, Steiner Ranch consisted of two parcels with different ownership structures. Tract B, consisting of 3,711 acres was slated for mixed-use development. This parcel included 4 1/2 miles of lakefront property on Lake Austin (where there are now some of the most expensive homes in Austin), frontage on Market Road 620, an important thoroughfare in Austin, and approximately 1,000 acres slated for golf course development surrounded by upscale homes. (Tr. at 539:6-540:14; 3863:24-3864:3; 3858:19-3859:17; PX 7 at 7938; PX 63 at 1643, 1657; Tr. at 1761:13-23; 3871:22-3872:3.) Tract A was approximately 752 acres of undeveloped land, planned for immediate phased residential

subdivision development. Water and electricity were in place with a preliminary plat with more than 4 lots per acre. (PX 7.) The proposed contribution of Tract A was the right to 80 percent of the profits from the joint venture that held title to Tract A. (PX 255 at 2; PX 300 at 1747, 1751 ("Parcel A will be contributed through the conveyance of an 80% partnership interest owned by Applicant")); (PX 326 at 1000; Tr. at 5066:2-25 (Coile); Johnson Dep. 137:17-25, 146:21147:7; Goings Dep. 3367:20-337:1, 338:5-10, 338:14-18,357:8-11.)

The appraisal submitted with the Application valued Tract A at approximately $15 million and Tract B at $55.7 million. (PX 7-13.) Regulators at the time of the transaction valued Tract B at $47.9 million. (PX 255; PX 259.) Handwritten notes from late 1987 indicated the Chief Appraiser of the FHLB-Dallas Appraisal Department had internally valued the 80% profit interest in Tract A at 80% of $12 million, or $9.6 million. (PX 252; Tr. at 5202:19-5203:9.) Mr. Lewis, plaintiffs' expert appraiser's valuation for Tract B was approximately $45.9 million at the time of the transaction. (Tr. at 3958:17- 3964:6, 4185:23-4186:5.)

One of the government's counters to the agreed-upon equity valuation of the contributed properties, particularly Steiner Ranch, Tract B, was that the $22 million cost to accelerate an option on that parcel represented the market value of that tract. The court declines to make such a finding. The $22 million was the price of removing an encumbrance, not the fair market value of what was contributed to the thrift. A little history of some other than basic real estate encumbrances is required. Through

sundry circumstances, in 1981, Tommy Steiner sold a 250-acre tract to Jim Monaghan for $5,000 an acre. Steiner also granted Monoghan a five-year option to purchase the balance of the ranch in a single purchase of $5,000 per acre the first year, accelerating $500 each year until the price was $7,500 per acre in 1986, the final year of the option. (PX 136 at 1; Tr. at 1610:4-9; Tr. at 508:6-509:4; Steiner Dep. 55:16-19, Aug. 23, 1991; Steiner Dep. 17:4-11, June 27, 1997.) The plot thickened. Steiner's father was very upset because he thought the option price was too low--thought he could have obtained $15,000 or $20,000 per acre. Steiner then placed an oil and gas lease on the ranch, thinking it would prevent the exercise of the option. (Pls.' PFF 41.) Yet, even with that lease, the 1981 option had considerable value and was sold several times before being acquired by two Austin developers--John Watson and John Simmons. (Steiner Dep. 56:1-22, Aug. 23, 1991; Steiner Dep. 19:15-20:17, June 27, 1997; Tr. at 1610:10-11; Tr. at 511:13-25.)

In 1985, Hughes was brought into the 1981 option by Watson and Simmons to renegotiate and extend the 1981 option. Watson and Simmons were relegated to a non-controlling, limited partner role. (Tr. at 1613:22-1614:7, 1616:20- 1621:4.) Before negotiating with Steiner, Hughes was approached by the Bass Brothers-investors from Fort Worth, Texas--to enter a joint venture to develop the ranch. In the end, Steiner rejected Bass' offer of $32 million cash, deciding to joint venture with Hughes instead, anticipating a share in the profits which he thought at the time would be around $45 million. (Pls.' PFF 46-48.)

With this history, in early 1985, Hughes renegotiated the 1981 option with Steiner. The agreement was memorialized on the back of Purina Horse Chow stationery. (Tr. at 525:6-19: 922:24-923:3.) Numerous agreements were signed which significantly changed the 1981 option. (Pls.' PFF 49-70.) The oil and gas lease was lifted; the total take-down was eliminated, meaning the option could be exercised for less than the whole parcel; and financing was arranged including cross-collateralization of financing on parcels on which the option was exercised to other parcels. Steiner Ranch Development Corporation ("SRDC") would develop Tract A and Steiner Ranch Limited ("SRL"), a limited partnership, owned the option. (Pls.' PFF 51.) To finance the development, Hughes obtained a $30 million line of credit and an $18 million option line of credit from Bright Banc Savings Association (`Bright Banc"). Hughes remained personally liable on both Bright Banc loans. Profits from development were not expected until later years of development--estimated to be the last 40% of development. (Pls.' PFF 61.) In the end, Hughes was in control of the option and the development. (Pls.' PFF 58.)

In 1986, SRDC purchased the fee interest in the 750 acre Tract A (considered to be more developable with maximum density lower-priced homes). (Pls.' PFF 64.)

That purchase left Tract B, subject to the option/profit sharing agreement. In early 1987, Steiner and Hughes arrived at an accelerated option price for Tract B--a lump sum in lieu of payments over the period of the renegotiated option and profit-sharing. Under the 1985 option, the total to acquire

Tract B was calculated at approximately $27.8 million (at 750-acre increments at $7,500 per acre). For various reasons, Steiner agreed to a $22 million price that was roughly the present value of the future income stream. (Pls.' PFF 64-70.) As a result, Hughes acquired the right to accelerate the option to acquire Tract B for $22 million. Hughes had no obligation to accelerate the option; he retained the right to proceed under the 1985 option in 750-acre increments at $7,500 per acre, or $27.8 million. (Pls.' PFF 69.) The government's assertion that the $22 million is (or was) the market value for the property is accordingly rejected.

Valuations of the properties

While regulators certainly preferred troubled thrifts be acquired with cash rather than real estate, which lacks liquidity and has fluctuating values, contribution of real estate was not uncommon during this time of thrift failures as regulators sought to avoid industry collapse. Satterfield, the most senior regulator at the FHLB-Dallas who was personally involved in this acquisition, was also involved in some 100 other thrift acquisitions during the 1987-1989 time frame, a number of which were made with non-cash contributions. Other regulators testified contribution of real estate was not unusual despite risk and uncertainty. (Pls.' PFF 93.)

Understandably, the values of the properties proposed for contribution were a major concern of FHLB-Dallas. The appraisal department of FHLB-Dallas performed the "highest" level of review--an "evaluation." The Hughes appraisals were first reviewed at the "desk" level, then field reviews were

conducted--including a physical examination of the parcels and analysis of market data. Short of conducting an independent full appraisal (and the Dallas office had performed a full appraisal on only one occasion), these 14 contributions received the highest level of scrutiny. Indeed, Professor Barry, testified that in more than the half-dozen *Winstar*-related cases in which he was called as an expert witness, several of which involved real estate contributions, he knew of no instance of higher regulatory appraisal review. (Pls.' PFF 100.)

There was considerable discussion between FHLBB and FHLB-Dallas about the properties. Concerns were expressed and addressed. FHLBB relied on the Dallas office to value the properties. In mid-1987, Mr. Coile, the Chief Appraiser of FHLB-Dallas, and his appraisal staff reviewed the appraisals submitted with the Application and were not satisfied. (Pls.' PFF 101-103.) A meeting was held on October 1, 1987 between six appraisers from FHLB-Dallas, Hughes, Gregson, and the private appraisers who had prepared the submittals. As a result of this meeting, Hughes' private appraisers amended their appraisals several times, submitting them to FHLB-Dallas. The FHLB-Dallas review of the revised appraisals were then submitted for supervisory review. (Pls.' PFF 104; PX 55; PX 86; PX 100; PX 117.)

Following the October 1, 1987 meeting, FHLB-Dallas supervisors requested Coile and his staff go beyond appraisal review and conduct "evaluations" on the 14 parcels--an atypical request in a supervisory conversion. Coile and his appraisal staff personally inspected and independently analyzed

each of the 14 properties, including its condition, location, maintenance, occupancy levels, rent rolls, comparable sales and rents, operating statements, ownership of chattels, and utility costs. (Pls.' PFF 105.) Coile described the task as "reviewing for a value conclusion." (Tr. at 4928:20-4929:5.) Coile personally visited almost half of the Section 8 projects, including properties in Austin and San Antonio, as well as Robin Square in Dallas. He visited Steiner Ranch and one of the comparables listed in the appraisal of that property. Coile toured Steiner Ranch with Hughes and Ray Fletcher, FHLB-Dallas District Appraiser. During that site visit, Hughes pointed out the favorable terrain and views and Coile did not recall having any doubts or reservations about value. Coile thought Steiner Ranch had beautiful views and would be a nice development. (Tr. at 5121:23-5022:3 (Coile); Tr. at 1641:1-1643:1 (Hughes).)

During all investigations, Hughes cooperated fully with regulators, providing four-year operating histories for each of the apartments and arranging meetings with Hughes' personnel in charge of developing Steiner Ranch and Waterford Centre. (Pls.' PFF 116-18.) Thereafter, the FHLB-Dallas appraisal department advised Satterfield that the apartments seemed to be "okay," although Robin Square was the "bad boy of the group," and the appraisals submitted with the Application were reasonable estimates of value so long as the Section 8 contracts and Hughes' excellent management remained in place. (Pls.' PFF 111- 31 (summarizing review and conclusions of regulatory appraisers).)

The Waterford Centre was undeveloped, but the

FHLB-Dallas was aware that the submitted appraisals estimated its value as developed. (Pls.' PFF 136; PX 51 at 1980.) A review in September, 1987 concluded the appraisal was deficient. By mid-October, 1987 the submitted appraisal for Waterford Centre was found to be in "reasonable compliance with professional appraisal standards and FHLBB Memorandum R-41c." (PX 55 at 1; PX 58.) After inspecting expenses, competition, absorption periods and development costs, on December 16, 1987, FHLB-Dallas District Appraiser Lipscomb physically inspected the property and met with Gregson and Mr. Boss of Hughes' organization, obtained data from the City of Austin Building Permit section, and met with representatives of HCI hospital planning to build on the site. District Appraiser Lipscomb concluded that his "[p]hysical inspection, construction schedules, external research and interview with both hospital and Hughes people tend to support probable success of the project as proposed" and the "value" of Waterford "probably approaches the values estimated in the project appraisals after modifications were received." (PX 50 (onsite inspection report dated December 16, 1987 outlining construction schedule including county approval of roads within development, obtaining notice to proceed for water, wastewater, paving and drainage, with commencement of construction of medical office building within a year and the Beverly Heritage Hotel within a year and a half).)

Regulators also knew Steiner Ranch was undeveloped and its value depended upon further development. As disclosed, Tract B was going to be contributed in fee simple; and El Paso was "to participate as a joint venture partner in the profits

from Tract A." (PX 255 at 2; PX 300 at 1747, 1751 (Hughes advises FHLBB that "Parcel A will be contributed through the conveyance of an 80% partnership interest owned by Applicant."); PX 326 at]000.) Indeed the option agreement and the SRL partnership agreement was submitted to regulators in the Second Amendment to the acquisition application. (PX 289 at 6725, 6731- 66.) On four days in December of 1987, District Appraiser Fletcher inspected Steiner Ranch and most of the comparable sales except for one which was inspected by Chief Appraiser Coile "to confirm the reasonableness of the value estimates as promulgated by the W.F. Smith report (plaintiffs' appraiser) or to determine as possible a reasonable value range" which was concluded to be $12,322 per acre. (PX 66.) Coile kept supervisory officials Hovey and Satterfield informed of these matters. (Pls.' PFF 147.) Coile gave Satterfield an estimated equity figure, but neither Coile nor Satterfield could recall the number. Johnson, one of the three regulators most involved in the transaction, testified that the values reached by the appraisal staff were "typically somewhat less" but "usually" "not much less" than that which Mr. Hughes had proposed. (Pls.' PFF 148.)

After Coile and the FHLB-Dallas appraisal staff completed their evaluations of the 14 properties, Satterfield, head of the supervisory agents at FHLB-Dallas and head negotiator in the Hughes acquisition, took the lead at a December 30, 1987 meeting with Hovey, Coile, Hughes, Freedman and Gregson "to complete the negotiation of the transaction and [ ]complete the negotiation of the amount" of "equity investment by Mr. Hughes." (Tr. at 5999:11.20.)

Mr. Satterfield testified:

A: [T]he meeting to me was to complete the negotiation of the transaction and primarily to complete the negotiation of the amount that we would be--allow [sic] as an equity investment by Mr. Hughes for the properties, etc., that he's going to bring in.

Q: Now, this is the meeting, of course, where the $35 million number was set, right?

A: Yes.

Q: Okay, Was that a market value determination?

A: Here's the problem: You get into semantics.

In 1987-'88 when we were dealing with this, we never though about we would be sitting in a court of law arguing about a term. That was a term that was used, but the actual amount that was given was a negotiated amount that was given as an equity figure.

Q: Well, now, had you visited any of the 14 contributed properties?

A: No, I did not.

Q: Who were you relying on for information about the value of the properties?

A: Well, primarily I relied on our appraisers.

Q: And do you distinguish between a negotiated value and a market value determination?

A: Well, yes. You could--you get into semantics and might say a negotiated value and an estimated market value are similar because

> you're estimating. You really don't know what the market value is until you sell it, but there is a difference, but from a regulatory terminology, that's what we used.

(Tr. at 5999:16-25-6001:1-3 (Satterfield); Pls.' PFF 165-67.)

Mr. Satterfield was most concerned about the Section 8 properties because "low-income housing was not the type of property typically considered for infusion into an insolvent thrift." (Tr. at 6145:7-25 (Satterfield).) At the December 30, 1987 meeting, he asked Hughes to personally guarantee the apartments would generate $1 million per year net of debt service for ten years. Secondly, Satterfield also wanted Hughes to continue to manage the Section 8 properties because of the positive reports he had gotten about the competency and organizational skills of Hughes' management team, understanding that the cash flow from these apartments depended upon skilled management. (Pls.' PFF 159-60.) Thirdly, Satterfield required Hughes agree not to sell the properties for less than their book value without prior consent of the Supervisory Agent. These three conditions were raised and agreed to at the December 30, 1987 meeting. (Pls.' PFF 161-62.) After Hughes agreed to these three conditions,[22] Mr. Satterfield set the $35 million net equity value for the properties. (Pls.' PFF 163-66.)

Regulators wrote in contemporaneous

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[22] Hughes' written agreement in this regard is discussed above.

memoranda that the equity value of the contributed properties totaled $35 million. (Pls.' PFF 169-73.) Hughes felt the properties had more than $35 million in equity, but agreed to less in order to make the deal. (Pls.' PFF 174.) Other documents refer to the $35 million as an "estimate"--an approximation of the aggregate equity value of the 14 parcels to be contributed. (Pls.' PFF 175.)

After the meeting, Coile allocated the $35 million in equity among the properties in a January 12, 1988 memorandum to Hovey. Ms. Hovey was an Assistant Vice-President with the FHLB-Dallas, and the regulator "most involved" in this transaction. In making the allocation, Coile did not consider Hughes' ten-year income guarantee on the Section 8 apartments. (PX 255.)

Coile's numbers were used by Hovey, Supervisory Agent, and Barclay, Principal Supervisory Agent, in their January 20, 1988 digest to the FHLBB (directed to Linda Plye, Director of Corporate Activities, ORPOS).[23] (PX 259.) Accordingly, Coile's supervisors and those advising the contract-makers--the FHLBB--referred to these allocations as "net estimated appraisal value (after debt) of $35,000,000." (PX 259 at 2.) "The appraisal department of the Federal Home Loan Bank of Dallas inspected all of the properties to be contributed and endorses[24] the values presented

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[23] The proposal summary by FHLB-Dallas also describes the contributions as coming from Hughes ("... the following properties being contributed by Mr. Hughes...") (PX 259 at 2.)

[24] "Endorse" is "to give approval to; support; sanction (to 'endorse' a candidate)." *Webster's New World Dictionary* p. 449 (3d 1986).

above." (PX 259 at 3.) This memorandum went through six reviewers. (PX 278.) The January 20, 1988 memorandum from Barclay, Principal Supervisory Agent to Plye, Director, Corporate Activities at ORPOS similarly referred to "net estimated appraisal value [after debt] of $35,000,000 ... being contributed by Mr. Hughes." (DX 464.) Indeed, even the FHLBB Approval characterizes the infused property as having "an aggregate net estimated appraisal value (after debt) of $35 million." (PX 338 at 3.)

To recap, the Application proposed contribution of equity of $47.3 million. After meetings and negotiations between appraisal representatives from plaintiffs and the government, the net aggregate value of the contributed real estate was reduced from $47.3 million to $35 million as memorialized in the First Amendment to the Application dated February 10, 1988. "Hughes shall ... cause partnerships and corporations controlled by Hughes to capitalize El Paso Holding with certain parcels of real estate... [with] net appraisal value (after debt) of $35 million." (PX 354, Tab 2 (HS100166).)

The government claims the parties did not agree on the equity or value of the properties required to be contributed, citing Corbin on Contracts § 1113 (interim ed.2002).

> [W]hen the plaintiff is given the alternative remedy of restitution, the amount of his recovery is determined by the value of the performance that has been received by the defendant, and not by the value of that which was promised the defendant.... the price or rate fixed in the contract ... although admissible in evidence in an action

> for restitution, is not conclusive on the question of value as against either the plaintiff or the defendant.

(Def.'s Post-Trial Br. at 106-07.) That return of required contribution is constrained by the values set by the government at the time of the deal is neither unfair, unjust nor a windfall.[25] While the government was not purchasing the properties, it was agreeing on valuations for the purposes of determining regulatory capital compliance. Dr. Barry, one of the government's expert witnesses, testified that if the properties had that equity, New El Paso would have sold them to recover cash that could have been invested in income-earning assets, which in turn would have reduced the carry costs of these properties. On the other hand, it would have been imprudent to sell the properties in a depressed real estate market.

Consistent with the foregoing, in his communications to regulators, Hughes and his representatives spoke of the proposed contribution, as negotiated, as $35 million. (PX 257 at 1; PX 272 at 4277, 4280, 4285; PX 289 at 5049, 6795; PX 313 at 2; PX 327 at 571.) The initial August 18, 1987 Application (PX 190) described the properties to be contributed and their values (later adjusted downward) net of debt. (PX 190 at 0922-23, 1092,

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[25] Indeed, the court notes that in June of 1990, Hughes offered to settle all disputes with the government for return: of the 12 Section 8 apartments and Waterford Centre. Over the government's objection, the court allowed evidence of this offer on the issue of unjust enrichment/windfall. Fed.R.Evid. 408. That offer did not factor into the court's analysis.

1627.) The January 15, 1988 Executive Summary (PX 257), the February 3, 1988 First Amendment (PX 272), the March 10, 1988 Second Amendment (PX 289), Freeman's April 1, 1988 Memorandum to Satterfield (PX 313), the April 22, 1988 subordinated Debt Application (PX 327) contained similar language. (Pls.' PFF 293-317.)

Furthermore, while in some *Winstar*-related acquisitions, real properties were allowed to be contributed and "booked" for regulatory purposes at higher than their market value, such a forbearance was considered unnecessary in this transaction because "the determination of the market value of the property [was] inherent to the transaction." (PX 798; Tr. at 5727:20-5733:10 (Hovey); Pls.' PFF 263-269.)

More than a year after the acquisition was approved, internal regulatory documents continued to describe the contributed properties as having equity of $35 million. (PX 574 (FHLBB examination report of El Paso Holding dated June 23, 1989); PX 616 (FHLB-Dallas Regulatory Plan for New El Paso described infusion of approximately $35 million in appraised equity").) In August 1989, a regulator wrote in an internal memorandum that "Mr. Hughes acquired the former El Paso Federal SA in May 1988, contributing (through El Paso Holding Corporation) approximately $35 million in real estate properties and $11.5 in qualifying subordinated debentures." (PX 602 at 2823.)

The court is guided by the Federal Circuit's instruction that It] he ascertainment of damages is not an exact science, and where responsibility for damage is clear, it is not essential that the amount

thereof be ascertainable with absolute exactness or mathematical precision: `It is enough if the evidence adduced is sufficient to enable a court or jury to make a fair and reasonable approximation.'" *Bluebonnet Sav. Bank v. United States*, 266 F.3d 1348, 1355 (Fed.Cir.2001) (quoting *Elec. & Missile Facilities, Inc. v. United States*, 189 Ct.Cl. 237, 257, 416 F.2d 1345, 1358 (1969)). "If a reasonable probability of damage can be clearly established, uncertainty as to the amount will not preclude recovery." *Locke v. United States*, 151 Ct.Cl. 262, 267, 283 F.2d 521, 524 (1960) (citation omitted). The court, therefore, embraces the principle that "when damages are hard to estimate, the burden of imprecision does not fall on the innocent party." *LaSalle Talman Bank, FSB v. United States*, 317 F.3d 1363, 1374 (Fed.Cir.2003). Here, however, the damages involved lack imprecision. The amounts are fully supported by the record evidence.

In addition to the negotiated agreement, the valuation amounts found here are supported from the retrospective appraisal of the contributed properties by plaintiffs' expert appraiser, David Lewis.[26] Mr. Lewis appraised all 14 of the properties

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[26] Lewis is an M.A.I. appraiser licensed in Texas, where he was born and raised in a family with four generations of appraisers. He worked as an appraiser in Texas since the early 1960s and, at the time of trial, lived 12 miles from Steiner Ranch. Other professional designations include that of Senior Residential Appraiser ("SRA") and Counselor of Real Estate for the American Society of Real Counselors ("CRE"). (PX 823.)

Lewis served as a member of the City of Houston Planning Commission from 1972 to 1975. From 1978 to 1980 he was the managing local consultant to the City of Houston in appraising over a million properties for ad valorem taxes. He was a

as of May 27, 1988 and opined that the value of these parcels would not have varied substantially between December 31, 1987 (the day following the December 30, 1987 meeting between Hughes and regulators at which agreement was reached that the equity contribution would be $35 million) and May 27, 1988 (the date of the closing of this transaction and the date of Lewis' evaluation). Government witnesses, particularly Ronald Hendricks, the government's expert appraiser, and Dr. Barry did not offer opinions of fair market value of the equity contributed. An adverse inference from this omission is not necessary as there is ample affirmative evidence to support the court's findings in this regard. *See Brasseler, U.S.A. I, L.P. v. Stryker Sales Corp.* 267 F.3d 1370, 1384 n. 7 (Fed.Cir.2001)

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founding member of the Board of Directors of the Harris County Appraisal District which was responsible for the appraisal of all properties in Harris County.

In 1992, he was a consultant to and headed the negotiating team for the Metropolitan Transit Authority in the purchase of 158 miles of transportation corridors from the Southern Pacific Railroad. In 1993, he addressed the American Bar Association, Section of Natural Resources, Energy and Environmental Law, Litigation and Real Property, on "Environmental Considerations and the Elements of Value Affecting Real Property."

Lewis has acted as development, transactional, valuation and market damage consultant on various environmental issues and was qualified and testified as an expert witness in environmental lawsuits. Forbes magazine, December 31, 1990, quoted him concerning real estate damage due to the stigma of electromagnetic fields. He has lectured on real estate economics and valuation at the University of Houston, the American Institute of Real Estate Appraiser, and the Society of Real Estate Appraisers. (PX 823, Section V [curriculum vitae].)

(invoking missing witness rule).

The bottom line of the Lewis appraisals is that the aggregate value of the contributed properties was $94,200,000, which is within ten percent of the approximate $101 million in value reached by regulators--around $35 million in equity and $66 million in debt--reached at the December 30, 1987 meeting. (PX 822 (Waterford Centre appraisal); PX 823 (Steiner Ranch appraisal); PX 824 (appraisals of Section 8 projects); Pls.' PFF 318-48.)

The government called Mr. Ronald L. Hendricks, M.A.I., from Nevada City, California. He was not asked to appraise any of the 14 parcels: "I have no value opinions." (Tr. at 6988:12-6994:13 (Hendricks).) Despite expressly distancing himself and denying any opinion as to market value, Hendricks concluded that the opinions of value given by Lewis should be adjusted downward and, in some instances, given specific monetary adjustments. When questioned, Hendricks conceded his "adjustments" to Lewis' appraised values may have violated professional appraisal standards.[27] (Tr. at 6988:12-6994:13, 7005:4-18.) Moreover, considerable testimony was elicited at trial as to Hendricks' status as a licensed appraiser in California that did not reflect favorably on his credibility. (Pls.' PFF 355-359.)

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[27] Mr. Hendricks was questioned about USPAP (Uniform Standards of Professional Appraisal Practice) Advisory Opinion 20 ("Illustrations of the Language in an Appraisal Review Report with an Opinion of Value"). Generally, appraisers are precluded from giving opinions of value unless and until they have done certain investigations.

Lewis' work was also criticized by government witness Professor Christopher Barry. (*See* Tr. at 7385-7501; DX 1527 at 20-35.) Professor Barry was not an appraiser; his criticism of Lewis' 9% capitalization rate in valuing the income-producing Section 8 apartments (particularly the Robin Square project which was subject to adverse news treatment in the *Dallas Morning News*[28]) and his other criticisms were adequately discounted and do not alter the court's findings herein.

Contribution and purchase of subordinated debts

In Amendment No. 2 (PX 289) dated March 10, 1988, the $11.5 million initially proposed to purchase preferred stock was amended to a purchase of subordinated debentures.[29] This Amendment noted that El Paso Federal had suffered an additional ten million dollars in losses from September 1987 to March of 1988, increasing the thrift's negative net worth to over $27 million.

Plaintiffs' request for money-back restitution includes this $11.5 million contribution. The

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[28] "Regardless of the condition of the Robin Square apartments which were featured in the Dallas Morning News, this project, along with the other properties was appraised, examined, and observed by government regulators and values agreed-upon.

[29] A subordinated debenture is a note or obligation of the thrift requiring payments over time. While the debt is secured, it is subordinated to most other creditors, hence its name. Qualifying subordinated debentures could be included in a thrift's regulatory net worth. *Winstar*, 518 U.S. at 846 n. 2, 116 S. Ct. 2432 (1996).

government's objections are that Hughes really did not "contribute" $11.5 million and the details were not fully disclosed to regulators.

As amended, the Application proposed purchase of two classes of subordinated debt of the new thrift. Hughes personally contributed $1.5 million into the thrift and the thrift, in return, issued the Series B subordinated debenture. (PX 409.) Regulators approved the inclusion of this amount in regulatory capital. (PX 365.)

According to the May 1988 Bank Board internal OGC memoranda, "T.C. Steiner and Son, a Texas General Partnership and Steiner and Sons, Ltd. (the `Steiner Partnerships') will purchase 100,000 shares of the Series A subordinated debt for an aggregate purchase price of $10,000,000 in cash." (PX 343 at 3). For tax reasons, Hughes was substituted as the purchaser. Simplified, but disclosed to regulators prior to the closing of the merger/acquisition, the total debt on the Steiner Ranch fee parcel was $21.5 million. The thrift only paid out $11.5 million. On May 27, 1988, Hughes executed a promissory note payable to Mr. Steiner for the remaining $10 million. The contribution Hughes "made" was to give Steiner a $10 million note in return for Steiner reducing his secured debt by that sum. As a result, in paying off the debt (and correspondingly increasing equity) the thrift paid out $10 million less. The cash flow to the thrift is the same as if Hughes paid $10 million cash to the thrift and the thrift paid $21 million to Steiner.

The government's argument concerning net contribution

The government argues that regardless of how the court resolves value, chain of title and materiality (discussed hereinafter), value must be reduced by benefits conferred on plaintiffs by regulators as part of the deal or by the subsequent operation of the thrift. Otherwise, plaintiffs would be placed in a better position than if the contract had not been breached.

New El Paso paid-off the debts on the contributed properties for which Hughes was personally liable. The government argues this debt payment should be deducted from any recovery as an offsetting benefit. The financial details in this regard were complex--but it is not necessary to determine whether Hughes was personally liable on these debts, or whether his liability was triggered, if at all, upon foreclosure of the security and pursuit of deficiency judgment. While payment of outstanding debt on the contributed properties may or may not have been a good business decision, it was the equity of these contributions (value minus debt) that was negotiated and contractually required.[30] Both the existence of

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[30] Amendment No. 2 to the Application included responses to questions raised by ORPOS and provided an opinion from the accounting firm Coopers & Lybrand concerning the tax treatment of subordinated debentures. That letter states that the real estate would be contributed to the new thrift, along with its mortgage debt. The thrift might pay off the mortgage debt with cash, some of which would be used to purchase the Series A subordinated debentures. In that event, the thrift would own the properties free and clear. (PX 289 at SF 6674-75.) The government does not contend that payment of the debts had to be approved

the outstanding debt and the possible payment of those debts by the thrift after acquisition were disclosed. To the extent that debt was paid, the thrift's equity interest in the contributed properties increased. And when the real estate market in Texas recovered, the thrift would recover not only the newly increased equity, but also any subsequent appreciation.

The government argues plaintiffs not only benefitted from payment of the debts on the properties, but Hughes received interest payments on the subordinated debentures. However, these "benefits" did not come from government and were not required by the contract. Furthermore, they were not windfalls. There was no showing that the interest paid on the subordinated notes was in excess of what would be reasonable.

Only benefits received from the government are offset.

> [G]enerally, any award of restitution to a plaintiff should be offset by the benefits he or she already has received from the defendant.... However... Landmark makes clear that offset is only proper where the benefits at issue were received directly from the breaching party. The [$1.2 million dividend plaintiffs received from the thrift] was not received **from** the government, nor pursuant to any **requirement** of the contract.

Hansen Bancorp. Inc. v. United States, 367 F.3d 1297, 1315-16 (Fed.Cir.2004) (*citing Restatement (Second) Contracts* 384 cmt. a).

Finally, the "benefits" cited by the government--even assuming the benefits as suggested--were not

established as appropriate offsets to recovery. Consideration is bargained for and received from the other contracting party at the time of contract formation--not derived from subsequent favorable results inherent in that bargain. The thrift's business decision to pay off the debts on the contributed properties may have resulted in a "benefit" to Hughes or the Holding Company, but payment was neither bargained for nor required. Rather debt payment was a collateral consequence of the transaction. Accordingly, as *Hansen Bancorp* informs, to the extent Hughes and/or the Holding Company benefitted from the thrift's payment of debt on the property or from interest payments on the debentures, those benefits were neither received from the government nor paid as a requirement of the contract and are not benefits to be deducted from the return of agreed-upon value of contributions awarded here. *Hansen Bancorp*, 367 F.3d at 1316-17.

In a related defense, the government argues that Hughes would have lost these properties if the contract with the government had not been breached. As framed, this inquiry is related to the government's familiar "would have failed anyway" defense derived from Admiral, discussed hereinafter.

The goodwill forbearance was a condition precedent and required contributions were made in reliance on that promise

Contrary to many *Winstar* cases, this was an unassisted transaction, meaning the government did not provide cash or other consideration to plaintiffs to acquire the troubled thrift. Government witnesses testified at trial that the goodwill forbearance was the only consideration given by the government. Mr.

Satterfield, Director of Corporate Activities for ORPOS, with delegated authority[31] to approve the El Paso supervisory conversion, and the lead regulator who negotiated the transaction on behalf of the FHLB-Dallas, testified:

> Q. And in connection with this acquisition, you recall that El Paso Holding asked for no cash contribution from FSLIC, right?
>
> A. That's correct.
>
> Q. And you understand that there was a forbearance request so that the value of intangible assets resulting from the accounting for the merger in accordance with the purchase method could be amortized by New El Paso, the resulting institution, over a period not to exceed 25 years?
>
> A. That's correct.
>
> Q. That's the goodwill forbearance?
>
> A. Yes.
>
> Q. And that forbearance is what allowed New El Paso, the resulting institution, to count the intangible asset of goodwill as capital for regulatory reporting purposes?
>
> A. Well, it counted it as an asset, which basically did not affect the capital, yes.
>
> Q. Well, and that forbearance that was granted by regulators allowed El Paso to amortize that

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[31] ORPOS' delegated authority was shared with FHLB Office of the District Banks and Office of General Counsel, with the latter focused on legal aspects of the conversion. The former's role was minor.

goodwill over 25 years?

A. Yes, as an expense.

Q. You understood forbearances were granted by regulators only in cases where the forbearance was actually needed for the transaction to be consummated?

A. Yes.

Q. And, in fact, you recall that FSLIC had a policy to that effect:

A. I mean, that was a general policy that started in the early `80s. yes.

Q. You understood that if supervisory goodwill were not counted as regulatory capital that on the day that El Paso opened, the day after the transaction, it would have failed capital requirements?

A. Well, it would never have been allowed to open.

Q. And the forbearance allowing El Paso to count goodwill as regulatory capital, in fact, was necessary if the transaction was going to result in a thrift that met regulatory capital requirements?

A. That's correct.

Q. And other than the forbearance granted in connection with the application, you're not aware of any other obligation that the United States government was contractually required to perform in connection with the acquisition, isn't that correct:

A. Not in connection with the acquisition, no.

Q. And you're not aware of anything of value that was contractually required to be given to El Paso Holding or Mr. Hughes from the FSLIC other than the forbearance?

A. That's correct.

(Tr. at 6131:21-6133:25 (Satterfield).)

Janet Hovey, Supervisory Agent, also testified that this forbearance was the sole consideration:

Q. And the only thing of value that the FSLIC provided in this transaction or the Federal Horne Loan Bank Board or the Federal Home Loan Bank of Dallas was the forbearance that it agreed to?

A. As far as the goodwill, yes.

Q. Yes.

A. Yes.

Q.... when the goodwill was taken away in 1989 with FIRREA, it--FIRREA was taking away the only thing of value that the government had provided in the transaction?

A. That could be viewed that way, yes.

(Tr. at 5738:5-11 (Hovey).)

The government argues, however, that the goodwill forbearance was not the only consideration provided by regulators. Approval of the acquisition itself resulted in the conveyance of the troubled thrift's buildings, branches, employees, computers, equipment and furniture. Consideration, however, by definition must be positive. Plaintiffs' description is apt--"absent the goodwill forbearance, all plaintiffs

received was a multi-million dollar debt that was not bargained-for and was not worth a peppercorn." (Pls.' Reply Br. at 6.) Alternatively, the conveyance of the thrift and its assets was inherent to the transaction--it was not consideration.

The government points to other forbearances granted as sources of consideration. For example, in forbearance No. 2, regulators agreed to exclude investments then in the thrift's portfolio in calculation of equity risk investments. (PX 366.) While the consequences of this forbearance is not before the court (and the parties do not detail the practicalities of this limitation), it is apparent that this forbearance, as well as the other forbearances, are or were of value **only if the thrift was open**. Regulatory capital was the "gateway." The elimination of that "gateway" eviscerated the other forbearances.[32] Remove the goodwill forbearance from the bundle of forbearances and there is no bundle at all.

The FHLBB Approval, Forbearance Letter and

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[32] Forbearance No. 1 addressed potential failure to meet regulatory net worth requirements of Section 561.13 due to "an increase in the contingency factor attributable to [New] El Paso." (PX 336 at 1.) Forbearance No. 2 permitted the thrift to "exclude all investments currently in [it] s portfolio in determining the amount available for equity risk investment." (*Id.*) Forbearance No. 3 allowed the thrift to reduce its liquidity requirement under certain circumstances. These forbearances were valuable only if the thrift was open and depended upon regulatory capital. *See Hansen Bancorp*, 367 F.3d at 1312 ("[T]o significantly narrow that gateway [to the enjoyment of the other contractual rights] violated material conditions in the contracts. The breach was `substantial,' depriving the companies of the benefit of their bargain.") (citation omitted.).

various internal memoranda reviewing the Application confirm that the government entered into a contract allowing New El Paso to count supervisory goodwill toward regulatory capital and amortize it over a 25 year period. On January 20, 1988, Barclay, the Principal Supervisory Agent, and Hovey, Supervisory Agent, informed ORPOS that "[t]he consummation of the acquisition is based on the assumption that certain regulatory forbearances will be granted ... [including] [a]mortization of goodwill arising from purchase accounting, for regulatory purposes, by use of the straight-line method over a 25 year period." (PX 259 at 3-4.) Barclay and Hovey wrote that they had no supervisory objection to the requested forbearance. (*Id.* at 4.)

The right to treat supervisory goodwill as an intangible asset amortized over 25 years was a **condition precedent** to the acquisition of the troubled thrift. Supervisory goodwill was a material term of the agreement at the time of contracting. The question is whether that materiality remained a year later in the months leading up to and after FIRREA, its implementing regulations, and application to this thrift. As applied, materiality at the time of breach has become somewhat of a negative-causation burden placed on plaintiffs. The government's position is that materiality or totality of the breach means the plaintiffs must establish that the thrift would have survived (i.e., not be taken over) but for the elimination of regulatory capital and amortization. Plaintiffs counter that burden is not correct and, in any event, this thrift would have survived as best evidenced by regulators' pre-FIRREA assessments of New El Paso. Unlike

Admiral, where it was clear that the thrift was failing, regulators' assessments of New El Paso (discussed in more detail hereinafter) were that the thrift had sufficient regulatory capital to survive until the economy improved and that any insolvency was some two years away.

The even-still evolving *Winstar* principles counsel that if it is clear that a thrift is headed towards failure before the effects of impending FIRREA legislation were felt,[33] then FIRREA's breach was not total. If FIRREA really had no relevant impact--i.e., the government promise was no longer material--then the breach was not material, substantial or total. On the other hand, if the importance of the government's contractual forbearance did not dissipate due to economic downturn and other conditions preventing the thrift from selling or developing its real estate assets during economic downturns, the forbearance remains material and substantial. Indeed, to the extent a regulatory capital cushion would buy time, that cushion could become more important as economic strictures tighten. The line on this continuum does not need to be drawn in thin air. The court concludes that it was not at all clear that this thrift would have failed pre-FIRREA. The court rejects the "would have failed anyway" defense regardless of whether the burden was on plaintiffs to prove the thrift would not have failed, or on the government to prove that it would. FIRREA was a substantial, material, and total breach. Money-back restitution/reliance is appropriate.

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[33] " The court credits testimony that regulators and the banking industry felt the effects of FIRREA before its passage.

The government's promised treatment of supervisory goodwill was the *sine qua non* of these contracts. In assuming a material breach, the Federal Circuit stated: "it is clear that the Government's promise that was breached had substantial value.... [G]iven the choice between purchasing a failing thrift without the Government's promise regarding supervisory goodwill and purchasing one with it, a reasonable banker would surely take the latter." *Glendale Fed. Bank v. United States*, 239 F.3d 1374, 1381-82 (Fed.Cir.2001). In *Winstar*, the Supreme Court explained that supervisory goodwill was "essential" and "indispensable" in the acquisition of insolvent thrifts, and FIRREA was essentially an "act of repudiation." 518 U.S. at 839, 849, 850, 891-903 & n. 52, 116 S.Ct. 2432. The inquiry is whether the breach went to the heart or key precept of the contract and whether plaintiffs' claimed damages reflect the amount that plaintiffs contributed based on the crucial promise of goodwill treatment.

Contractually required contributions in *Winstar* cases are recoverable as either "money-back restitution," or, alternatively, as reliance damages. *Landmark*, 256 F.3d at 1372-73 (affirming trial court's award to plaintiff equal to value of plaintiff's initial contribution, noting that award could be made under either reliance or restitution theory); *Glendale Fed. Bank v. United States*, 378 F.3d 1308, 1313 (Fed.Cir2004), *cert. denied*, 544 U.S. 904, 125 S.Ct. 1590, 161 L.Ed.2d 277 (2005) ("We have allowed restitution for the limited purpose of returning the acquiring thrift to the status quo ante when specific initial contributions to an acquired thrift have been established."); *LaSalle Talman Bank v. United*

States, 317 F.3d 1363, 1376-77 (Fed.Cir.2003) (same result under reliance theory); *Far W. Fed. Bank v. OTS*, 119 F.3d 1358, 1365-66 (9th Cir.1994) (affirming restitution award equal to initial cash contribution); *RTC v. FSLIC*, 25 F.3d 1493, 1504-06 (10th Cir.1994).

Recently, the Federal Circuit reversed an award of $118 million for initial contributions in an assisted transaction under both restitution and reliance theories. In *Old Stone Corp. v. United States*, 450 F.3d 1360 (Fed.Cir.2006), these related concepts and their application in *Winstar* cases were summarized. Suffering a total breach, an aggrieved party "`is entitled to restitution for any benefit that he has conferred'" on the breaching party "`by way of part performance or reliance.'" 2006 WL 1420817, at * 8, citing *Mobil Oil v. U.S.*, 530 U.S. 604, 608, 120 S.Ct. 2423, 147 L.Ed.2d 528 (2000) (citing *Restatement (Second) of Contracts* § 373 (1979)) and *Landmark*, 256 F.3d at 1372. And, "restitution may be measured by either `the value of the benefits received by the defendant due to the plaintiffs performance' or `the cost of the plaintiffs performance, which includes both the value of the benefits provided to the defendant and the plaintiff's other costs incurred as a result of its performance under the contract.'" *Old Stone* at 1371 n. 5 (citing *Hansen Bancorp*, 367 F.3d at 1314 (quoting *Landmark*, 256 F.3d at 1372)). "We have suggested that restitution of initial contributions of both stock and cash in *Winstar* transactions may be allowable because both forms of contribution confer a benefit on the government." *Id.* (citations omitted). The breach must be "total" in that the non-breaching party would have a claim for total as opposed to partial breach. *Id.* at 1371 (citing

Restatement (Second) of Contracts § 373 cmt. a). The breach is deemed to be partial rather than total when the non-breaching party continues performance. After FIRREA, Old Stone did not terminate the assistance agreements and contracts and did not file suit for restitution. Instead Old Stone waited three years after FIRREA before asserting a right to restitution, and entered into a new Capital Plan with regulators concerning regulatory capital for the thrift. The government relied on Old Stone's "election" to continue its performance to its detriment by allowing the thrift to continue to operate, resulting in additional losses to the insurance fund. Accordingly, the Federal Circuit reversed restitution of initial contribution, holding Old Stone had a claim for damages but not restitution/return of benefits conferred or bestowed. New El Paso made no such election.

The Federal Circuit characterized the thrift's request for return of contributions under reliance, as a "loss caused by reliance on the contract." *Old Stone*, 450 F.3d at 1374-75, (citing *Restatement (Second) of Contracts* § 344(b)) such as pre-breach investments. *Id.* (citing *Westfed*, 407 F.3d at 1368, 1371 and *Glendale*, 239 F.3d at 1383). Reliance damages must be foreseeable and proximately caused by the breach. *Id.*, citing *Hughes Commc'ns Galaxy, Inc. v. United States*, 271 F.3d 1060, 1066 (Fed.Cir.2001). Both pre-requisites are met here. FTRREA caused (1) the seizure of the thrift and (2) the loss of the required contributions of real properties valued by the parties at $35 million and $11.5 million in cash equivalent to acquire subordinated debentures. It was certainly foreseeable that the $46.5 million, negotiated and

required contractual contributions, would be lost if the government revoked its promise to allow the amortization of the negative net worth of the acquired thrift, which was a condition precedent to the acquisition and the gateway to the deal. *See Westfed*, 407 F.3d at 1365-66 (rejecting government's claim the thrift would have failed anyway, citing negotiations and regulatory admissions that without the forbearance, the acquired thrift would have immediately been out of regulatory compliance, and the Business Plan that contemplated several years until profitability, which assumed continuing regulatory capital forbearance).

"'The underlying principle in reliance damages is that a party who relies on another party's promise made binding through contract is entitled to damages for any losses actually sustained as a result of the breach of that promise.'" *Westfed*, 407 F.3d at 1368, citing *Glendale Fed. Bank v. United States*, 239 F.3d 1374, 1382 (2001). The Federal Circuit in *Glendale* reversed an award of restitution of the failed thrift's net liabilities on the date of the merger, in favor of Glendale's reliance interest because, "[r]eliance damages will permit a more finely tuned calculation of the actual losses sustained by plaintiff as a result of the Government's breach." 239 F.3d at 1383. *Westfed* affirmed an award of reliance damages for actual costs and expenditures made in reliance on the agreement with the government. "Westfed is entitled to that amount it actually expended to acquire Old Western in reliance on the forbearance promise, which the government repudiated." Id. at 1368 (citing *DPJ Co. v. FDIC*, 30 F.3d 247, 250 (1st Cir.1994) ("[R]eliance damages aim to `restore to the claimant what he or

she spent before the opportunity was withdrawn.'")).

Restitution has been applied to return the non-breaching party to the "*status quo ante* instead of relying on the terms of the contract to obtain damages." *Admiral*, 378 F.3d at 1344. Restitution requires a "total breach" defined as one that "so substantially impair[s] the value of the contract to the injured party at the time of the breach that it is just in the circumstances to allow him to recover damages based on all his remaining rights to performance." *Mobil Oil*, 530 U.S. at 608, 120 S.Ct. 2423 (quoting *Restatement (Second) Contracts* § 243 (1979)); *see also Hansen Bancorp*, 367 F.3d at 1311 ("[T]he critical part of this formulation is the statement that the breach `substantially impairs the value of the contract to the injured party at the time of the breach.'"). "[T]he breach `must be of a relatively high degree of importance.'" *Hansen*, 367 F.3d at 1312 (citation omitted). Drawing from the *Restatement*, the Federal Circuit set forth five circumstances that are significant in determining whether a breach is total or material:

> (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
>
> (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
>
> (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
>
> (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking

account of all the circumstances including any reasonable assurances;

(e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

Hansen, 367 F.3d at 1312. While discounting the importance of the third circumstance, the court stated that the first "will always be a pertinent consideration." *Id.*

In *Landmark*, the Federal Circuit affirmed the trial court's award of $21.5 million--for "real estate and cash valued at $21.5 million," contributions made as required under the contract with the government. 256 F.3d at 1370, 1373. *Landmark's* rationale and result apply with equal force here. "'The Government must give the companies their money back.'" *Id.* at 1377 (citing *Mobil Oil*, 120 S.Ct, at 2438).[34]

It may not always be that "restitution" means "reliance," although the practical import can be the same. *Granite Mgmt. Corp.*, 416 F.3d at 1380. "[Theories of restitution and reliance] may be analyzed together because ... a restitution claim 'based on recovery of the expenditures of the non-breaching party in performance of the contract'... 'can be viewed as a form of reliance damages.'" *Id.* (citing *Landmark*, 256 F.3d at 1373 ("In any event, the government's argument is irrelevant with respect to Landmark's initial contribution because

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[34] Awards have been for the value of required contributions. The government's suggestion that the value of the required contributions here be reduced by the phantom costs of liquidation to award only net realizable equity, is rejected.

the amount of the award would be identical under either standard.")). Accordingly, the court determines that the government's breach was total, substantial and material; the contributions here were required and made in reliance on the government's promise of regulatory forbearance.

Materiality of breach

Regulators and examiners did not regard New El Paso troubled before FIRREA. To the contrary, the thrift was recognized as having sufficient capital to survive until the Texas economy improved. In this regard, the court is mindful that the Business Plan filed with the Application focused on a three year plan which would give time for the economy to recover. Recalling that the acquisition was approved and the transactions subsequently closed in May of 1988, regulators' assessments of New El Paso after the acquisition and prior to FIRREA belie the government's vigorous dissection of the thrift and prediction of ultimate failure. Regulator's assessments also illustrate the materiality of the goodwill forbearance and thus the materiality of FIRREA's breach.

December 1988 limited scope examination

From December 13-28, 1988, FHLB-Dallas conducted a limited scope examination. (PX 469 at 0606 (regulators' memorandum as to scope of examination).) The examiner-in-charge was Javier Vasquez, who was identified by the government as a potential witness but was not called. (PX 488.) While limited in scope, examiners' assessments of targeted aspects of the thrift stand in stark contrast to their

assessment less than a year later with the anticipation and enactment of FIRREA. Plaintiffs suggest an adverse inference from the government's failure to call this witness is warranted. *See Brasseler, U.S.A. I, L.P. v. Stryker Sales Corp.*, 267 F.3d 1370, 1384 n. 7 (Fed.Cir.2001). New El Paso was given a MACRO rating of "2".[35] (PX 907; PX 616 at 1449 (listing then previous 12/31/88 examination rating); Tr. at 2090-91 (Hughes).)

First, analysis of "interest rate gap management" (the difference, or "spread" between interest earned or paid to the thrift on mortgages and interest paid out by the thrift to depositors and others), questioned whether rates on the thrift's adjustable rate mortgage portfolio were capped, but concluded "the risk controlled arbitrage activities of the Association" were "currently acceptable" and "the principal objectives of the institution [ ] have been achieved with minimal risk associated." (PX 488 at 1546, 0163-64.) While the need for appointment of a Chief Executive Officer ("CEO") was noted, as was a previously-voiced concern about the number of Hughes' family members on the Board of Directors, the examiners concluded that post-merger policies and procedures "provide management with sufficient guidelines to effectively supervise the affairs of the institution..." (PX 488 at 0163.) The Business Plan submitted with the Application was also reviewed (PX 469 at 0606); the examination report did not

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[35] MACRO was a regulatory acronym used to identify areas of review of an assessment of a thrift's financial condition. Ratings ranges from a high of "1" to a low of "52" MACRO components were: management, asset quality, capital adequacy, risk management and operations. (Tr. at 6166.)

report adversely in this regard. (PX 488.) The thrift's MACRO rating in this limited examination was "2."

During this time [August 5, 19881, Hughes was nominated to serve on the Board of Directors of the FHLB-Dallas. (PX 431.)

December 1988 to March 1989 internal regulators' memorandum

Between December of 1988 and March of 1989, regulators prepared an internal memorandum concerning New El Paso stating that: "capital is currently reported at $45 million--equivalent to 10.9% of assets. We do not foresee any threat of deterioration or insolvency because of the current capital position." The prior MACRO rating from the limited scope examination was noted, as was a "full scope examination ... scheduled to commence in April, 1989." The memorandum recommended the thrift's classification be changed from "distressed" to "marginal" and that the thrift be "monitored." Because it had $43 million of goodwill on the books (10.9% of assets), "[w]e do not foresee any threat of deterioration or insolvency because of the current capital position." (PX 907.) The thrift's problems were primarily attributed to large loans made during 1983 through 1986 before this acquisition. The memorandum was signed by Mickle, the Supervisory Agent responsible for New El Paso. (PX 907.) At trial, Mickle confirmed that there was no threat of deterioration or insolvency because of the thrift's capital position at that time. (Tr. at 5550:7--12; 5552:312 (Mickle).)

March-May 1989 full-scope examination

Regulators conducted a full-scope, "top-to-bottom" review and examination of the thrift from March 13 to May 23, 1989. The Examiner-in-Charge, Joanne Cohen, was also identified as a witness by the government but was not called. The report was delivered to New El Paso on September 1, 1989--three weeks after FIRREA was passed. Regulators gave the thrift a composite MACRO rating of "3" defined in the FHLB Regulatory Handbook--Thrift Activities as follows:

> Institutions in this category exhibit a combination of weaknesses ranging from moderately severe to unsatisfactory. They are only nominally resistant to the onset of adverse business conditions and could easily deteriorate if concerted action is not effective in correcting the areas of weakness. Institutions which are in significant noncompliance with laws and regulations may also be accorded this rating. Their overall strength and financial capacity is such to make failure only a remote possibility. Such institutions are vulnerable and warrant special supervisory concern.

(PX 608 at 0264.) Operating losses of $1.4 million in the nine-month period ending March 31, 1989 were attributed primarily to the increasing cost of funds. While problems were noted, the report concluded "regulatory capital is sufficient to absorb additional losses until such time as the real estate market rebounds and nonperforming assets are transformed into earning assets." (PX 608 at 0264.) So, 90 days before FIRREA was passed, regulators, having

completed several months examination of the thrift, opined that although there were serious weaknesses, New El Paso's possibility for failure was "remote" and the thrift had sufficient regulatory capital to absorb additional losses until the economy improved and real estate values were restored at which time a healthy thrift would emerge.[36]

Prior to delivery of the September 1, 1989 report, regulators conducted an exit interview/presentation at New El Paso. (Tr. at 2094-21:2095:2 (Hughes).) Participants at the May 1989 meeting included Cohen, and Supervisory Agent Mickle as well as New El Paso's Board of Directors and senior staff. A transcript of the taped meeting was provided to regulators. At the meeting, Cohen complimented New El Paso's asset classification system as one of the best she had ever seen and regulators deemed asset quality "generally good." (PX 608 at 0274.)

Shortly after delivery of the September 1, 1989 report, Supervisory Agent Mickle circulated internally an assessment, a "regulatory plan" for New El Paso. (PX 616.) This plan was periodically prepared as a method for reporting to senior management in Dallas and Washington. (PX 616; Tr. at 5369:5-18 (Mickle) ("senior management" or "anybody in the Federal Home Loan Bank Board of Dallas [who] want[ed] to know the current status of El Paso, they would pull this document up on their computer.") (Tr. at 5523:5-18 (Mickle).) MACRO

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[36] During this time period, related programs were referred to as the "Phoenix Project." The phoenix was a mythical bird that, after being consumed in the fire of its funeral pyre, arose from the ashes with the freshness of youth. *LaSalle Talman Bank*, 317 F.3d at 1366 n. 2.

ratings for the March to May 1989 examination were "3's" with one "22" (PX 616 at 1449.) Insolvency was noted to be 24 months away. (*Id.*) This high-level assessment by regulators close in time to FIRREA was (1) any insolvency was two years away; and (2) New El Paso's business plan was "viable, assuming necessary regulatory approvals for the acquisition" of another thrift "is obtained.") (PX 616 at 1449, 1457; Tr. at 5517:1-18; 5521:20-5522:12 (Mickle).) As noted elsewhere, one of the several collateral consequences of New El Paso's regulatory capital deficiency was growth limitations. New El Paso needed to grow, but couldn't because its promised regulatory capital cushion was eliminated.

Enactment of FIRREA

FIRREA was enacted on August 9, 1989 and implementing regulations became effective on December 7, 1989. FIRREA undermined New El Paso's capital requirements and subjected it to consequences attendant that failure. Indeed, government counsel admitted that New El Paso was in capital compliance until FIRREA. (Pre-Tr. Con£, at 154:11-13 (Sacks).) Thereafter, New El Paso failed "due to FIRREA." (PX 672 (regulatory summary monitoring report dated December 1989) ("Did the institution fail its capital requirement for the first time during this month? [sic] Due to FIRREA? Yes").) On December 1, 1989, Dan Rabon for the District Director, OTS informed New El Paso it would be out of capital compliance on December 7, 1989 and had to submit a plan for rectifying that deficiency. "We recognize that the new requirements are substantially different than the old ones and

that the effective date does not provide a great deal of time to assimilate these new requirements." *Id.*) The thrift's failure to meet capital "requirements is largely the result of goodwill on El Paso Savings' books which equaled approximately $42,491M as of October 31, 1989." (PX 702 at 1235.) Ultimately, the thrift's MACRO rating plummeted to "5," defined therein as "[t]he volume and character of weaknesses are such as to require urgent aid from the shareholders or other sources. Such institutions require immediate corrective action and constant supervisory attention. Obviously, formal supervisory action is presumed necessary. The probability of insolvency is high for these institutions." (*Id.*)

New El Paso had more than $42 million of goodwill capital on December 6, 1989, (DX 700 at 0549 (line 788)), that did not count under FIRREA's new tangible capital requirements the following day. (PX 757 at 1.) The day before the effective date of the regulations, Hughes sued OTS and others in the United States District Court for the Western District of Texas to enjoin application of FIRREA's capital standards in lieu of the goodwill forbearance. Hughes did not declare a partial breach or elect to continue performance. (PX 647, 650); *see also Old Stone Corp.*, 450 F.3d at 1369-70.

To recap, materiality of the breach is determined at the time of the breach. FIRREA's breach was material as the foregoing contemporaneous regulatory examinations and statements support. While the government, including its expert witness Kennedy, presented many post hoc arguments and analyses, contemporaneous assessments by regulators are in stark contrast to those criticisms

and the conclusion that the thrift would have failed anyway. Moreover, Kennedy's opinion was based on the assumption that the growth and other operational restrictions following FIRREA had no impact on New El Paso, an assumption that the court rejects. While the immediate impact of FIRREA was the elimination of goodwill, the secondary consequences of capital deficiency were severely restricting.

To be sure, the government has pointed out a myriad of other problems and criticisms of the thrift. True, New El Paso's first year performance was not as projected; true, the amount of supervisory goodwill increased from the approximately $19 million assumed in the original application--some $25 million more by the time of closing in May 1988, or a total of approximately $44 million. This $25 million increase reduced New El Paso's earnings by around $3.5 million per year--over $1 million annually as amortization ($25 million amortized over a 25year period), plus an additional approximately $2.5 million annually from loss of anticipated earning assets ($25 million in assets which could have generated income at 10 percent or $2.5 million a year in "lost" income.). (Tr. at 602:4-604:1; 854:2-6; 855:1-856:13; 1974:13-22 (Gregson).) Also, New El Paso's actual losses exceeded those projected. The federal subsidy on Robin Square was lost; the project was abandoned, resulting in a one-time loss of $2.6 million. A rise in interest rates led to lower than anticipated sales of real estate owned. Real estate values fell even further. However, as recognized in the Business Plan, neither immediate profits nor a sudden turn-around were expected or planned. Time was necessary for the economy to

strengthen and real estate prices to return. Regulatory capital was the recognized cushion from which continued losses could be absorbed until the economy improved.

On July 2, 1990, the State of Texas appointed James Wright as Conservator. [37] (PX 763; Tr. at 2396:20-25 (Hughes).) The lead reason for the conservatorship was "insolvency on a tangible capital basis and ... [failure to] meet the capital requirements of [FIRREA and a Texas Rule]." (PX 763 at 1.) After managing New El Paso for nearly two months, Wright, who had over 30 years of experience managing and regulating thrifts, believed it to be a viable thrift.[38] His assessment of the thrift was consistent with regulators' assessments pre-FIRREA. He wrote to the Commissioner of the Texas Savings and Loan Department on August 20, 1990. (PX 775.) His points included AccuBank Mortgage (a subsidiary of New El Paso) as the "key to profitability" and recommended approval of an application to expand AccuBank which would improve profitability "considerably." Wright complained that confidential information had been leaked a banking industry publication, then picked up by a local reporter that had the potential to damage New El Paso's franchise value. Noticeably

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[37] The July 2, 1990 Order of the Commissioner of the Texas Savings and Loan Association granted Wright the authority to "manage the affairs" of New El Paso and its subsidiaries, and "take charge of the[ir] books, records, property, assets, liabilities, and business." (PX 763 at 3.)

[38] Although included in the government's witness list, Wright was not called as a witness.

absent from his assessment is any claim that the thrift "would have failed anyway." Indeed, his refutations of many of the defenses the government makes in this litigation, is accorded significant weight. And, an adverse inference is added given the government's failure to call him as a witness. Wright's words were strong and specific:

> Having reviewed the Capital Plan, I find it difficult to understand how liquidation or merger under the FDIC [Federal Deposit Insurance Corporation] method is less expensive than the Open Thrift Assistance request would be to the Insurance Fund. It appears that in almost every correspondence that we receive from OTS that there is a considerable amount of comment relating to the competency of management. During the time I have been at the Association, I find that management in place at this time is very competent and is capable of managing the Association in accordance with the proposed Capital Plan. I particularly take exception to their statement that the adequacy of management being incompetent remains unchanged with the placement of a Conservator in the institution by the Texas Savings and Loan Department. I doubt very seriously if any of the regulators that are making these decisions has thirty years of experience managing and regulating Savings and Loans as evidenced by my background. Likewise, qualified individuals have been employed by the Association who are working very diligently to correct deficiencies and to resolve exposures to the FDIC. Without Capital assistance it would be very difficult to return [New] El Paso Savings to a profitable

> position, although a substantial amount of net worth could be recovered if the Association were to be able to return Goodwill to Capital and also if Mr. Al Hughes converted the Subordinated Debentures to Preferred Stock which he proposed to do in the Capital Plan filed with OTS.

(PX 775 at OTS-06 001893.)

Wright also wrote that $7 million in general reserves required by regulators was excessive. New appraisals had been requested to support a lower reserve. Appraisals for the 11 remaining contributed properties indicated a value of approximately $21 million (PX 799-808), some $6.5 million more than what regulators had allowed. (PX 742.) Wright countered many of the operational criticisms voiced by regulators and fully supported the thrift's lawsuit against OTS regarding the loss of the goodwill forbearance.

Even after FIRREA, Hughes was negotiating the infusion of additional capital into New El Paso, but as he testified, any commitment was contingent on regulators honoring the contract to allow regulatory goodwill. (Pls.' PFF 906.)

The court finds that the actions of the parties before the onset of this controversy are most probative on the effect of FIRREA. The court does not find that New El Paso was without economic risk, nor that absent FIRREA New El Paso clearly would have survived, or would have survived for any set period of time. It is found, based on all the evidence and testimony of witnesses, that FIRREA was a substantial, material, and total breach. The only consideration (or, even under the government's

position at least a major component of consideration) for the contract was eliminated, comprising a material, substantial and total breach. If plaintiffs were seeking lost profits, future viability in this regard would be a valid concern. Here, however, plaintiffs seek a return of required contributions in circumstances where the thrift was not failing pre-FIRREA.

Immediately after passage of FIRREA, federal regulators began to take adverse action against New El Paso. In contrast to the somewhat critical regulatory reviews, reports, and treatment of New El Paso prior to FIRREA, with insolvency some two years away and sufficient regulatory capital to absorb losses everybody knew were going to continue until such time as the economy improved, on August 18, 1989, a week after FIRREA was passed, Supervisory Agent Mickle informed the FHLB-Dallas Regulatory Review Committee that "we will be asking the Board to sign a Supervisory Agreement." (PX 945 at 0553.) A Supervisory Agreement is the least intrusive form of administrative enforcement. (Tr. at 5509:14-5510:7 (Mickle).) Yet, three months later, November 15, 1989, Mickle recommended a Cease-and-Desist Order, although he did not testify to any intervening changes in New El Paso's condition. Regulators' attitudes changed. Tellingly, Mickle testified that the grounds he cited for a Cease and Desist Order were the same as he cited three months earlier. He "dressed-up" and enhanced these issues and failed to disclose that matters had been remedied.[39] (Tr. at

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[39] Subjecting New El Paso to stricter loan and other operational scrutiny enhanced the contractual breach. *Fox*

5539:5-25 (Mickle).)

Mickle's October 16, 1989 change of New El Paso's classification from "marginal" to "distressed," cites only insufficient capital as a reason. (PX 637 ("It appears very possible that the expected capital contributions may not be forthcoming, therefore, we are reclassifying this institution as distressed. Because the owner has indicated he has the ability to make the additional investment and has indicated he will do so to protect his existing investment, we have not classified this institution as `resolution' as per our discussion.").) One month later, on November 17, 1989, Mickle recommended further downgrading to "Resolution 2" because of internal regulatory classification changes, again solely because of capital reasons. (PX 651. ("The most recent revision to the Regulatory Monitoring System classified [New El Paso] as `distressed'. This is to recommend reclassifying this institution to `Resolution 2.' The institution is insolvent on a tangible capital basis and currently has poor prospects for meeting a 3% tangible capital requirement.").) Mickle's testimony reaffirmed that this downgrading was due solely to loss of capital, which was due to FIRREA. (Tr. at 5531:10-25 (Mickle).)

Besides eliminating goodwill, FIRREA also restricted New El Paso's ability to grow and imposed burdensome regulatory oversight because of the thrift's deflated capital status. Plaintiffs presented considerable evidence that regulators' failure to

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Valley Eng'g, Inc. v. United States, 151 Ct.Cl. 228, 240-41(1960).

approve (indeed even to react or respond to) pending requests to sell assets, or to invest in what could have been profitable ventures, sealed New El Paso's fate. The thrift could not show it was not going to fail because regulators would not respond to the thrift's attempts to do just that.

On December 1, 1989, regulators informed New El Paso that it would fail capital requirements on December 7, 1989, and was therefore subject to growth and operational constraints contained in Regulatory Bulletin 3a (RB-3a). (PX 660 (letter from Dan Rabon, for the District Director of OTS).) New El Paso could not:

> (1) Grow beyond net interest credited as of December 6, 1989;
>
> (2) Make any capital distributions;
>
> (3) Renew, rollover, or increase brokered funds without the approval of the FDIC;
>
> (4) Add any individual to the Board of Directors or employ any individual as a senior executive officer of the institution or holding company;
>
> (5) Make any equity investments; or
>
> (6) Act inconsistently with any other limitations on activities established by statute, regulation or by the OTS (including compliance with any existing supervisory orders or agreements).

(PX 660 at 0976.)

The consequential limitations from regulatory capital deficiencies prevented New El Paso from expanding. And growth was always understood as necessary for the deal to work. (PX 650.) As Mr.

Hughes testified, "We had always known that we needed to grow, that we had to cover the goodwill that [New El Paso] took." (Tr. at 2247 (Hughes).)

> Q. By not growing... if you cannot grow beyond the net interest credited, can you make loans, new loans?
>
> A. No, sir, you cannot.
>
> Q. Okay, Can you take additional deposits?
>
> A. No, sir.
>
> Q. And if you cannot make new loans, is there any way using traditional thrift operations that you can continue to make money?
>
> A. No, sir, you cannot.
>
> Q. What was the impact of the letter from Mr. Dan Rabon [PX 6601 on the operations of [New] El Paso?
>
> A. They were dramatic. We were--pretty well closed the institution as far as being able to continue on as a--in the plan that we had and move forward to profitability.

(Tr. at 2247:25-2248:1-15; Tr. at 5521 (Mickle) ("Q... Now, [New] El Paso had told you repeatedly that it wanted to grow because of the problem of the drag of its goodwill, hadn't it, sir? A. [T]hat's correct.").)

After FIRREA, regulators failed to respond to or rejected several of New El Paso's requests for approval, including its (1) Capital Plan, (2) application to purchase mortgage servicing, (3) request to sell the 11 Section 8 apartment projects, (4) request to sell Elmwood Fitness Center, and (5) request to make construction loans at Steiner Ranch.

(Pls.' PFF 916-971.)

In compliance with regulators' demands, New El Paso submitted a proposed Capital Plan on January 9, 1990 (DX 718), projecting compliance with new capital requirements by the end of 1990 by converting the $11.5 million in subordinated debentures into permanent capital and by expanding the servicing portfolio of its mortgage company subsidiary, AccuBank, to nearly $6 billion with minimal increase in costs. (Tr. at 2284:10-24 (Hughes).)

A review, completed two days later, concluded there were four areas where the Capital Plan was incomplete. (DX 723; Tr. at 6227:6-21; 6228:20-6229:4 (Casteel).) Usually, regulators would ask the thrift for any missing information. Here, despite New El Paso's "difficult financial straits" and "time was of the essence," regulators did not contact the thrift. (Tr. at 6330:6-15 (Casteel).) An unsigned draft requesting additional information from New El Paso was attached to an internal regulatory memorandum recommending rejection of the Capital Plan and requesting review by OGC counsel. "OGC counsel has no problem with our **intended** denial [of New El Paso's proposed Capital Plan] but has asked to review our correspondence **prior to its being sent to the institution**." (PX 963 (emphasis added).)

Regulators' lack of response was noted at New El Paso's March 28, 1990 Board meeting. "[W]e need to increase our mortgage lending portfolio. However, without getting our Business Plan approved, it is extremely hard to do that.... [Me are pretty well locked out of the lending market until they decide on our plan. Their decision was due February 27 and to

date they cannot estimate when we may expect a decision." (PX 715.) New El Paso wrote to regulators three times--on April 4, May 11, and June 8, 1990--complaining that it had not received a response to its Capital Plan. (PX 717 (April 4, 1990 letter from New El Paso responding to a March 27, 1990 letter from OTS denying a brokered deposit waiver "based upon serious deficiencies in your institution's capital plan ..." by asking "We have not received a reply from OTS or FDIC to our business plan and feel it somewhat onerous to reject our brokered deposit request based on business plan deficiencies without disclosing the deficiencies."); PX 949 at 0173-74 (May 11, 1990 letter to regulators enclosing "list of items waiting for (OTS) approval/response," the first of which was the Capital Plan); PX 979 (June 8, 1990 letter to OTS referring to "inaction" on Capital Plan).)

Regulators decided to wait to communicate with New El Paso until after completion of an examination in March of 1990.[40] (PX 975; *see also* PX 959 (March 29, 1990 internal regulatory memorandum noting denial letter was going through internal review).)

New El Paso's January 1990 Capital Plan was returned to the thrift on June 6, 1990, because regulators considered the plan "withdrawn" based on Hughes' statements at a May 31, 1990 Board of Directors meeting. (DX 1418.) Hughes denies making such a statement, the minutes of that Board meeting do not reflect such, and. Hughes'

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[40] Regulators consulted with counsel about this delay; counsel gave a "verbal concurrence." WX 975.)

subsequent communications deny it. (DX 774; PX 756; PX 979.)

On May 23, 1990, regulators ordered "write-downs" of the contributed apartments and Waterford Centre by $25 million. This paper reduction of capital would have most certainly negatively affected the Capital Plan. (Tr. at 6328:1-14 (Casteel).) A new Capital Plan based on Open Thrift Assistance was submitted because inaction on the January 1990 plan rendered much of it obsolete.

Shortly after FIRREA was enacted, Hughes acquired Shawmut First Mortgage ("Shawmut"), a mortgage servicing[41] subsidiary of Shawmut Bank in Dallas. Hughes testified he felt Shawmut was an opportunity to increase New El Paso's earnings and presented growth opportunities, particularly because the increasing number of thrift failures presented an emerging market for mortgage loan servicing. For various reasons, including a cumbersome and lengthy application process, Shawmut was acquired by a New El Paso subsidiary, renamed BancNet and later AccuBanc. Initially, Shawmut had over $1 billion in servicing and subsequently acquired $2

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[41] Mortgage servicing is accepting loan payments from borrowers and forwarding to the lienholders, less a small percentage. In addition to these periodic fees, new loans generated origination fees. Also Shawmut had a $30 million pool of non-interest bearing tax and insurance escrow accounts-essentially free deposits. New El Paso could earn sufficient income from these escrow accounts alone to pay for the cost of acquiring Shawmut. Mortgage servicing counted as capital under FIRREA. (Pls.' PFF 936-37.) During a December 1989 examination, OTS recognized the net positive benefit of the acquisition of Shawmut. (DX 704 at 0017; Tr. at 3726:6-12 [Hughes].)

billion more. Shawmut had originated new loans at the rate of $1 billion per year. This was (and would have been) a profitable business. Mr. Kennedy, the government's expert, testified there would have been substantial benefits to New El Paso if it had been permitted to purchase additional mortgage servicing. However, permission to expand in this area was not granted.

New El Paso arranged for a warehouse line of credit with Bank One to have additional lending capacity and purchase an additional $3 billion in loan servicing. However, New El Paso's request to acquire the additional servicing and the line of credit was denied. (Pls.' PFF 939-40.) New El Paso projected over $20 million in profits with the increased servicing portfolio. Regulators admitted to $5.2 million in profits in 1990 alone. (DX 781 at 0074; Tr. at 3787:1-25, 3728:18-3729:12 (Hughes); PX 770 at 0106 (state regulators stated in May 1990 that "AccuBanc was a profitable move").) Losses from a June 30, 1990 consolidated financial statement resulted from accelerated depreciation and a one-time write-down and balance sheet restructure used by Shawmut to reduce profitability. (DX 788 at 1590; Tr. at 2758:19-23, 2759:15-21, 3728:18-21 (Hughes).)

Shawmut (without the expanded loan servicing portfolio) was sold by the Resolution Trust Corporation ("RTC") for $75 million. RTC asked Mr. Hughes permission to use New El Paso's operating losses as offset to that gain, and Mr. Hughes agreed. (Pls.' PFF 942-43.)

New El Paso sought required approval for the sale of 11 of the Section 8 projects for approximately

$25 million dollars, with offers ranging from $1 to $2 million dollars down and promissory notes with interest at 8.5% to 8.8%. (PX 639 at 0970.) That the original estimated appraised value of the original 12 projects (Robin Square now excluded) was approximately $26 million, (PX 464; Pls.' PFF 944-60), is further support that this thrift could have survived absent the government's breach.

In early 1990, New El Paso was precluded from selling the Elmwood Fitness Center (for $5.4 million with $1 million cash down). March 9, 1990 Board minutes reflect "the proposed sale of Elmwood has been awaiting OTS approval." (DX 744 at 2144.) As was the case in denying sale of the Section 8 apartments, regulators denied the financing as counter to FIRREA's loan-to-one-borrower limitation ("LTOB"). Consequently, "[New El Paso] cannot make two loans on the leasehold improvements of Elmwood Fitness Center in the combined total of $5,400,000 without violation of the institution's LTOB limit." (PX 724 at 1; Pls.' PFF 961.)

New El Paso's ability to grow was so severely limited that it could not even make share loans--loans secured by existing deposits--without prior regulatory approval. Mr. Mickle was incredulous that New El Paso was prohibited from making share loans after FIRREA. (Tr. at 5547:5-6; 17-19 (Mickle).)

On May 18, 1990, Hughes forwarded a legal opinion he had obtained that regulators' decision "to preclude [New El Paso] from the sale of contributed assets is not in keeping with proper application of the loans-to-one-borrower limitations." (PX 740.)

New El Paso was precluded from construction financing and home mortgages at Steiner Ranch even though during the prior 18 months there had been no incidents of default. A January 22, 1990 request for permission was rejected by regulators on February 1, 1990. Thereafter, New El Paso made several additional requests, to which no response from regulators was ever received. (Pls.' PFF 964-65.) Plans to acquire other thrifts, which Hughes projected would lower cost of funds and reduce net operating losses, were thwarted by regulators as well. (Pls.' PFF 967-971.)

Plaintiffs suggest that the timing of the write-downs of the contributed properties, operational restrictions and failure to respond to requests for required approvals was posturing for just the argument the government makes here—that FIRREA was not material; the thrift would have failed anyway. (Pls.' PFF 927-28.) Such unilateral actions by the breaching party do not detract from the materiality of the breach.

The government relied heavily on the March 1990 post-FIRREA examination to assert FIRREA was not a material, substantial or total breach because New El Paso was going to fail anyway. (DX 781.) In category after category, regulators' conclusions were in stark contrast to pre-FIRREA assessments. Rutschman, the Examiner-in-Charge of the 1990, post-FIRREA examination, admitted that their examination was a "harder" look. (Tr. at 8430:11-23; DX 1380 at 0035 (draft of internal regulatory memorandum that "the current regulatory and legislative requirements" are "not the same old game anymore, so step up to the line and play by today's

rules").) The examination, however, found that New El Paso's inadequate capital was a significant, if not the most significant problem it was facing--commenting its "capital base was inadequate," it was "technically insolvent," and "failed to comply with the tangible, core, and risk-based capital standards established by FIRREA." (DX 781 at 0069.)

New El Paso digressed from a thrift with some admitted weaknesses (but with sufficient capital to weather economic recovery, with any insolvency some two years hence), to distressed, to Resolution 2 within three months after FIRREA. FIRREA was a material, substantial and total breach in that it "so substantially impair[ed] the value of the contract to the injured part[ies] at the time of the breach that it is just in the circumstances to allow [them] to recover damages based on all [their] remaining rights to performance." *Admiral Fin. Corp.*, 378 F.3d at 1344-45 (citations omitte.).

Plaintiffs are not seeking lost profits. Plaintiffs are simply asking for their money back because FIRREA was a total, material, and substantial breach. Return to profitability is not a hurdle plaintiffs must leap. The so-called "would have failed anyway," is a hurdle the government rightly raises in determining whether FIRREA was a total, material, and substantial breach or merely "'sheer happenstance.'" *Admiral*, 378 F.3d at 1345 (citing *Admiral Fin. Corp. v. United States*, 57 Fed.Cl. at 432). "In the event of such a breach, the non-breaching party is entitled to restitution whether the contract 'would, or would not, ultimately have proved financially beneficial' to the non-breaching party." Id. (citing *Mobil Oil*, 530 U.S. at 608, 120

S.Ct. 2423). The government did not meet its burden in this regard.

Tax gross-up

Plaintiffs claim an additional amount to compensate for taxes that might be paid on the award. A tax gross-up would not only be speculative, the government counters, but would be unfair because plaintiffs belatedly asserted this claim and the government did not have the opportunity for frill discovery. Also, a tax gross-up to cover taxes that may or may not be assessed could be an unfair windfall.

Over the government's motion in limine, the court allowed the written proffer of Bruce G. Barre, presented in unilateral question and answer format. (DX 1700.) Mr. Barre, an accountant for Hughes and his wife, Patricia, family and affiliated entities since 1985, prepared or supervised the tax returns for Hughes and his affiliates since 1987. He concluded that total federal and state income tax on an award of $46,500,000 would be no less than $2,905,172. (DX 1700 at 2.) On that basis, plaintiffs add that amount to their claim for relief.

Barre's opinion assumed a $35 million award to the Holding Company and a $11.5 million award to Hughes personally. He excluded a contingent fee payable to counsel as well as amounts due to the FDIC and the descendants of Thomas C. Steiner, Jr., deceased.

Barre's proffer acknowledged that a decision by the Supreme Court in *Commissioner v. Banks*, then pending before the United States Supreme Court, to

include contingent fees in gross income, would result in "substantial additional taxes." (DX 1700 at 4.) Subsequently, resolving a circuit split, *Commissioner v. Banks*, 543 U.S. 426, 429, 125 S.Ct. 826, 160 L.Ed2d 859 (2005) held that "as a general rule, when a litigant's recovery constitutes income, the litigants' income includes the portion of the recovery paid to the attorney as a contingent fee." Accordingly, Barre's contingent fee deduction was no longer appropriate.

Barre then submitted an Amended Proffer that the amount of minimum tax would not change because the contingent fees would be capitalized and added to plaintiffs' tax basis. The gross restitution award would be reduced by the tax basis (including the contingent fees) in calculating taxable gain--the same result as in his original proffer.

Noting expert testimony in this regard in the case then before it, the Federal Circuit "adopt[ed] the rule of other courts that a tax gross-up is appropriate when a taxable award compensates a plaintiff for lost monies that would not have been taxable." *Home Sav. of Am. v. United States*, 399 F.3d 1341, 1356 (Fed.Cir.2005).[42] Plaintiffs' burden is two-prong--to establish that the money (or here the equity in the real properties and cash for purchase of subordinated debentures) would not have been taxed,[43] and the damage award here would be taxed.

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[42] There was discovery in *Home Savings*, which, unlike this case, was a "Guarini" case concerning certain tax treatment promised by the government. Accordingly, expert reports presumably vented these issues.

[43] Query whether the determination that no tax would have been paid was the event of contribution, the time of the breach,

Id.

The government questions whether any award would be taxed because it represents replacement of a lost capital asset.[44] The court is sympathetic to the government's lack of discovery to explore what the tax treatment would have applied had these properties not been contributed in reliance on the government's promise. Complaints of lack of discovery aside, the government also pointed out that Hughes' tax liabilities have been sporadic, suggesting that taxes may not be as definitive as Barre opines.

In 1985, Hughes paid about $5,000 in taxes; in 1986, he projected a $115,000 refund; in 1987, he paid no federal income tax; in 1988, he paid $4,000 in taxes and in 1989, none. (PX 180 at SF1117; DX 3005-07.) Also, that the properties were held in various Hughes-related entities prior to their contribution involves transactions and tax treatment, the intricacies of which are not before the court. The taxability of this award, in whole or in part, and whether the award represents monies that would not have been taxable at either the time of contribution or at the time of breach, have not been determined on this record.

Trial courts "generally do not gross-up damage

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the time of the take-over, the time of liquidation, or some other time.

[44] This position may not be consistent with the government's position that the value of Hughes' contributions of real properties should be reduced by taxes and other costs of sale, and only the net realizable value be awarded as restitution/reliance damages.

awards to take into account the plaintiffs tax liability on the award unless a plaintiff can show with reasonable certainty that the gross-up is necessary to make plaintiff whole, the award will be subject to taxation and, for purposes of calculating the gross-up, that the award will be taxed at a certain rate." *Citizens Fed. Bank v. United States*, 59 Fed.Cl. 507, 521 (2004). The *Citizens Federal* court rejected a claim for gross-up as "too speculative to be awarded because the Court [did] not know that the award will be taxed nor the rate at which it would be taxed." *Id.* at 523. The same reasoning applies here.

Plaintiffs want to preserve their option to seek relief from possible tax consequences via RCFC 60(b). The government questions the use of Rule 60(b) as an appropriate vehicle for reopening a final judgment to consider a tax gross-up. The government asserts this would be a collateral issue, not an alteration of the judgment and points out that a Rule 60(b) motion does not require the court's leave.

Adopting the reasoning of *Bank of America v. United States*, 70 Fed.C1. 246 (2006) on the availability of RCFC 60(b) for ventilation of tax gross-up in *Winstar* cases, to the extent the award to Hughes is ultimately found to be taxable, but would not have been if there had been no breach (or no contribution or whatever the test for comparison may be), Hughes has the option to apply for Rule 60(b) relief.

Risk-shifting

Following initial post-trial briefing, the government filed a Renewed Motion for Summary

Judgment, contending that this court's prior holding in *Hughes I* was subsequently effectively overruled by *Admiral Financial Corp. a. United States*, 378 F.3d 1336 (Fed.Cir2004) ("*Admiral III*") a decision rendered after conclusion of trial and post-trial submissions in this case. The government asserts that a provision in the RCMDA signed by the Holding Company and FSLIC more than two weeks after the Application was approved, contains the so-called "successor regulation clause"-a concession that regulations could change which, in turn, could increase the Holding Company's obligation in the RCMDA to shore-up the thrift's capital to new, and potentially higher, standards.[45]

> All references to the regulations of the Board or the FSLIC used in this Agreement shall include any successor regulation thereto, it being expressly understood that subsequent amendments to such regulations may be made and that such amendments may increase or

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[45] In the RCMDA, the Holding Company agreed to maintain New El Paso's regulatory capital by infusing additional capital if necessary, to:

> [Clause the Regulatory Capital of the Resulting Institution to be maintained at a level at or above the Regulatory Capital Requirement, and as necessary, will infuse sufficient additional capital, in a form satisfactory to the Supervisory Agent, to effect compliance with such requirement and cure a Regulatory Capital Deficiency during the first quarter after which the Resulting Institution fails to meet its Regulatory Capital Requirement.

(Def.'s Renewed Mot. for Summ. J.App. 2.) Regulatory Capital was "defined in accordance with 12 C.F.R. § 561.13(b) or any successor regulation thereto." (*Id.*)

> decrease the Acquiror's[46] obligation under this Agreement.

(Def.'s Renewed Mot. for Summ. J.App. 2 [emphasis added].)

The court ordered supplemental briefs on the successor regulation clause. Plaintiffs assert *Admiral III* is distinguishable because the government "plainly" gave consideration in addition to the goodwill forbearance. Here, the regulatory goodwill forbearance was the only consideration given by regulators and if that could be taken away unilaterally, the acquisition agreement would be illusory.

Subsequently, the Federal Circuit in *Franklin Federal Savings Bank v. United States*, 431 F.3d 1360, 1370 (2005), held that there the government's approval of the transaction itself and alone was sufficient consideration to support the over-arching contract. To avoid the consequences of *Franklin Federal*, plaintiffs argue (1) the plaintiffs in *Franklin Federal* admitted (and touted) that the approval of the transaction was consideration and (2) the government waived this affirmative defense of assumption of risk by not properly raising it.

Under binding Federal Circuit precedent, the court concludes the Holding Company agreed to bear the risk that regulatory capital requirements could change both in amount and in constituent components, and that the issue is properly before the court, again. However, inquiry does not end there.

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[46] The Holding Company was the "Acquiror" in the RCMDA.

Hughes did not sign the RCMDA agreement; the RCMDA did not incorporate any of the other contractual documents; the Forbearance Letter is unconditional in its grant of amortization of goodwill for up to 25 years; and the amortization of goodwill forbearance was a condition precedent to the seminal offer here, the Acquisition Agreement.

Successor regulation language is not always the end of the road. Consistent with the fact-intensive Federal Circuit holdings in Winstar cases, *Hometown Financial Inc. v. United States*, 409 F.3d 1360, 1365 (Fed.Cir.2005), affirmed that the "correspondence, memoranda, forbearance letters, and regulatory maintenance and dividend agreements gave rise to a contract which included provisions addressing goodwill." The FHLBB Resolution approving the transaction defined regulatory capital as whatever the regulation provided at a given time, except that for the first five years, regulatory capital "shall take into account forbearances granted by the FHLBB by letter dated December 22, 1987 and those granted by the Principal Supervisory Agent of the Federal Home Loan Bank of Indianapolis by letter dated April 1, 1988." *Id.* at 1366. Parsing the clauses, the Federal Circuit noted that regulatory capital requirement, defined as that "at a given time computed in accordance with 12 C.F.R. § 561.13(b), or any successor regulation thereto, ... place [d] the risk of regulatory change on Hometown (the acquirer)." *Id.* at 1368 (parenthetical added). "However, that risk was superceded for the first five years by virtue of language immediately thereafter, ... **except that during the five-year period following consummation of the acquisition of the**

Institution, the Regulatory Capital Requirement of the Institution shall take into account forbearances granted by the FHLBB by letter dated December 22, 1987 and those granted by the Principal Supervisory Agent of the Federal Home Loan Bank of Indianapolis by letter dated April 1, 1988." *Id.* at 1367 (emphasis in original). The "except that" language trumped the general assumption of risk. Any other interpretation would read the "except that" qualifier as either "servient" or "out of the agreement altogether." *Id.* at 1368. The Federal Circuit distinguished *Admiral* and *Guaranty* as having different "topography," although *Guaranty* presented a closer question.[47]

Subsequently, in *Franklin Federal*, FHLBB's approval of the acquisition was conditioned upon Franklin Federal, the holding company, signing a Dividend Agreement. 431 F.3d at 1362 n. 1. The Dividend Agreement prohibited the holding company from receiving dividends if the thrift's regulatory capital fell below a certain level, and subjected the thrift to immediate seizure if its regulatory capital fell below that level for more than 30 days. *Id.* at

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[47] In *Guaranty*, a footnote to the definition of Regulatory Capital Requirement "incorporated" the forbearance letter. *Guaranty Fin. Sera., Inc. v. Ryan*, 928 F2d 994, 999 (11th Cir.1991). There is no cross-reference here. Reconciling two possibly inconsistent provisions-- the long-term amortization of goodwill in the forbearance letter (incorporated into the RCMDA) and the definition of regulatory capital, the Eleventh Circuit in *Guaranty* "interpreted the long-term amortization permitted in the forbearance letter as an exception good for as long as the regulatory environment did not change, but servient to the `risk-shifting' article." 409 F.3d at 1369.

1363. In negotiations, it was clear that the deal would not have been approved without the Dividend Agreement which recited that the Holding Company's commitment was "'in consideration of the FSLIC acting favorably on the Application for approval of the transaction.'" *Id.* (citation omitted). The Dividend Agreement included successor regulation language: "all references to regulations ... shall include any successor regulation thereto, it being expressly understood that subsequent amendments to such regulations may be made and that such amendments may increase or decrease the Acquiror's [the holding company's] obligation under **this Agreement**." *Id.* (emphasis added).

The Federal Circuit also concluded the integration clause of the Dividend Agreement did not incorporate the approval and forbearance letters because they were not agreements "but merely regulatory approvals that could only become enforceable by the mechanism of the Dividend Agreement." 431 F.3d at 1366. Because of difference in terminology ("regulations" versus "regulatory requirements"), *Franklin Federal* declined to find a conflict between the Dividend Agreement's successor regulation clause and the provision in the forbearance letter that it "shall not be construed to constitute forbearance ... with respect to any regulatory or other requirements other than those [specified in the forbearance letter]." *Id.* at 1360. Because the thrift had no cause of action, "we need not reach the issue of shareholder standing to enforce the alleged promise." *Id.* at 1371.

The Holding Company's RCMDA here has no integration clause. FHLBB's approval of the El Paso

acquisition was not conditioned upon the execution of the RCMDA.[48] Also, in *Franklin Federal* approval of the acquisition was sufficient consideration to support the holding company's dividend limitation and assumption of the risk of regulatory change. In the instant case, FHLBB's approval was on May 13, 1988; therefore the recital of consideration in the May 27, 1988 RCMDA (by FSLIC not the FHLBB) may be more rhetorical than real. The closing on May 27th was the acquisition of the troubled thrift.[49] And, in one of the many briefs in this case, the government explained that the RCMDA was a regulatory requirement: "[T]he [RMMDA], while not a contract, is at least signed by both the FSLIC and

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[48] "[T]he Holding Company Application regarding the acquisition of control of the New Institution and the Old Institution as a result of that merger is hereby approved; provided that the following conditions are complied with to the satisfaction of the Supervisory Agent[.]" (PX 338 at 000117.) Although several conditions are then specified (including an accountant's opinion that describes the intangible assets acquired by the thrift in the acquisition "including goodwill" [PX 190 at 000118] the signing of an agreement to maintain capital was not among them.

[49] Q: Now with respect to the actual closing of the transaction, you don't remember any document in which the Federal Home Loan Bank of Dallas or the Federal Home Loan Bank Board set forth the mechanics of how closing should occur, is that correct?

A: I don't recall anything like that.

Q: You don't recall seeing any document containing instructions or guidance with respect to closing, correct:

A: Correct.

(Tr. at 5791.)

[the Holding Company] (by Hughes) and places specific obligations on [the Holding Company]. The execution of the RCMDA was mandated by the regulations governing the FHLBB's approval of plaintiffs' application for supervisory conversion and merger and was signed on May 27, 1988, two weeks after the issuance of the forbearance letter." (Def.'s Reply in Support of its Cross-Motion for Summary Judgment Against Hughes and [the Holding Company], filed February 21, 2001, at 23.)

Admiral III has been applied to foreclose all recovery. In *Coast-To-Coast III v. U.S.*, 62 Fed.Cl. 469 (2004), unlike the case here, the forbearance letter contained successor regulation language.[50] *First Commerce Corp. v. United States*, 63 Fed.Cl. 627 (2005), also granted a motion for reconsideration, setting aside its prior opinion to the contrary, and dismissed based on the successor regulation language in the RCMDA signed by the parties. *See also, Bayside Fed. Sav. & Loan Assn u. United States*, 64 Fed.Cl. 15 (2004) (applying *Admiral III* where both applicants signed the RCMDA).

A condition precedent to the transaction in this matter was the extension of supervisory goodwill, amortized over up to twenty five years. That forbearance was granted in the May 13, 1988

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[50] "In the event any regulation or statute referred to herein is amended or succeeded by another statute, regulation or rule, then any reference to any such regulation or statute shall be deemed to refer to such regulation or statute as amended or the statute, regulation or rule which succeeds any such regulation or statute." *Coast-To-Coast Fin., Corp. v. United States*, 58 Fed.Cl. 327, 332 (2003).

approval by the Bank Board. (PX 338 at 10.) In the Forbearance Letter, the Bank Board reserved its right to take authorized action(s) against the newly-formed thrift except for the regulatory requirements waived including paragraph 3, the amortization of supervisory goodwill. "This letter does not and shall not be construed to constitute forbearance or waiver by the Board or the FSLIC with respect to any regulatory or other requirements other than those encompassed within the preceding paragraphs (1) through (6) and the statutory provisions authorizing imposition of the waived requirements, insofar as such requirements are waived, the Board and the FSLIC expressly reserve all their statutory rights and powers." (PX 336 at 2.)

Furthermore, the limited successor regulation language in the Approval Letter here is not consistent with the government's position. The section of the eleven-page Approval Letter granting FSLIC insurance to the new thrift is subject to several conditions including the infusion of the properties with $35 million of equity. Another condition is "[t]hat the new Institution [ ]comply with 12 C.F.R. §§ 562.9 and 563.16 **or any successor regulation**." (emphasis added.) The regulations cited are limited and do not include regulatory capital ("[e]ffective date of insurance; initial premium payment, issuance of certificate of insurance" and "[p]remiums in mergers, consolidations, or purchases of bulk assets" respectively). The Approval Letter qualified one condition by placing the risk of regulatory change on the acquirer. The forbearance grant to New El Paso was unqualified. The government points to no provision signed by Hughes in his individual

capacity to" over[come] the presumption that the promises contained in the forbearance letter were absolute." *Franklin Fed.*, 431 F.3d at 1369.

Hughes did not sign the RCMDA in his individual capacity. As the Federal Circuit recently differentiated, those who promise to maintain or guarantee capital levels, or contribute if capital falls below a certain level, do not have either the contractual rights or remedies of the parties to the underlying acquisition agreement. *See S. California Fed. Sav. v. United States*, 422 F.3d 1319, 1333-34 (Fed.Cir.2005). In the RCMDA in *Southern California* individuals agreed to infuse an additional $5 million if the thrift's regulatory capital fell below required levels. The Federal Circuit parsed the RCMDA as separate from the other contractual documents, declining to extend to the individual plaintiffs standing under the Assistance Agreement for breach of the promised contained therein. Conversely here, any waiver by the Holding Company in the RCMDA does not flow upward.

The two documents, while each part of the over-arching contract involved here comprising numerous documents, are separate. Accordingly, one must interpret two separate documents in this contractual melee.

> It is important to note that even though several instruments relating to the same subject and executed at the same time should be construed together in order to ascertain the intention of the parties, it does not necessarily follow that those instruments constitute one contract or that one contract was accordingly merged in or unified with another so that every provision in one

becomes a part of every other.

Franklin Fed., 431 F.3d at 1371 n. 8 (citing *Williston on Contracts* § 30:26 (4th ed.1990)).

The Forbearance Letter granting the amortization of supervisory goodwill was unqualified. With the exception of those specified forbearances, the FHLBB reserved all their statutory rights and powers. If possible, contracts are construed to give effect to all provisions, even potentially conflicting sections. "The principle that a contract is construed to give effect to all of its provisions does not exempt contracts with the United States." *First Nationwide Bank v. United States*, 431 F.3d 1342, 1347 (Fed.Cir.2005) (citing *Tecon Corp. v. United States*, 188 Ct.Cl. 15, 411 F.2d 1262, 1264 (1969) ("A construction of a contract provision which gives meaning to all its language is to be favored.")); *Hol-Gar Mfg. Corp. v. United States*, 169 Ct.Cl. 384, 351 F.2d 972, 979 (1965) ("Also, an interpretation which gives a reasonable meaning to all parts of an instrument will be preferred to one which leaves a portion of it useless, inexplicable, inoperative, void, insignificant, meaningless or superfluous."); *see also United States v. Johnson Controls, Inc.*, 713 F.2d 1541, 1555 (Fed.Cir.1983) ("[A]n interpretation that gives a reasonable meaning to all parts of the contract will be preferred to one that leaves portions ... meaningless; nor should any provision be construed as being in conflict with another unless no other reasonable interpretation is possible.") (cited in *Westfed Holdings, Inc. v. United States*, 407 F.3d 1352, 1359 (Fed.Cir.2005)). Thus it is concluded that Alfred J. Hughes in his individual capacity did not

assume the risk of regulatory change and, as a party to the acquisition contract, remains in a status to receive compensation for the contributions he contracted to make and that were made in reliance on the goodwill forbearance.

CONCLUSION

Accordingly, based on the foregoing:

(1) The government's Renewed Motion for Summary judgment dismissing the claims of El Paso Holding Corporation shall be **GRANTED** so that those claims are **DISMISSED**;

(2) The Clerk of Court shall **ENTER** final judgment in favor of Alfred J. Hughes in the sum of $46.5 million;

(3) All other pending motions are **DENIED** as **moot**.

II. Mr. Hughes Did Not Contract With The Government Regarding Goodwill

Because EPHC's acquisition of EPSA was completed without assistance from the Government, the participants did not enter into an assistance agreement or any other contract. Instead, the Government acted solely in its regulatory capacity when it approved the transaction. See, e.g., D&N Bank v. United States, 331 F.3d 1374, 1382 (Fed. Cir. 2003).[2] Mr. Hughes's role in the transaction was simply as a shareholder in the holding company, EPHC, that completed the acquisition.

Notwithstanding these facts, the trial court erroneously held that the Government had entered into a contract consisting of EPHC's application to acquire EPSA, FHLBB's letter approving the acquisition, and the RCMDA. Hughes I, 58 Fed. Cl. at 311-12. The court erroneously held that Mr. Hughes was

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[2] The acquisition was entirely unlike the three acquisitions at issue in Winstar, which involved admitted contracts (Assistance Agreements) with integration clauses that were held to incorporate the otherwise regulatory documents (e.g., resolutions and forbearances). Winstar, 518 U.S. at 862-65, 867. Here, there is no assistance agreement, simply regulatory approvals. This Court should not find a contract based upon documents that consist of nothing more than regulatory approvals - especially here, where the Agreement of Obligation in which FHLBB's joining is expressly limited and expressly provides that the FHLBB assumes no liability. All the more so should a Court be reluctant to find a contract in these circumstances when the party claiming privity is not even the thrift or its holding company, but someone like Mr. Hughes, who is one step removed from the transaction and is simply a shareholder.

3-3-08

No. 07-735

In the Supreme Court of the United States

ALFRED D. HUGHES, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly held that, under the express terms of their alleged contract with the United States, petitioners assumed the risk of future regulatory change that would prevent performance of the contract.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-15a) is reported at 498 F.3d 1334. The opinion of the Court of Federal Claims on liability (Pet. App. 16a-71a) is reported at 58 Fed. Cl. 291. The opinion of the Court of Federal Claims on damages (Pet. App. 72a-178a) is reported at 71 Fed. Cl. 284.

JURISDICTION

The judgment of the court of appeals was entered on August 29, 2007. The petition for a writ of certiorari was filed on November 27, 2007. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

This is one of the breach-of-contract cases that were filed after the enactment of the Financial Institutions

Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, 103 Stat. 183. See *United States* v. *Winstar Corp.*, 518 U.S. 839 (1996) (*Winstar*). Of the approximately 122 *Winstar*-related cases that were originally filed, only approximately 19 remain pending, and most of those cases, like this one, have nearly completed the litigation process.

1. Petitioners are El Paso Holding Company (EPHC) and its president and majority shareholder, Alfred D. Hughes (Hughes). This case arises from EPHC's acquisition of El Paso Federal Savings and Loan (El Paso), a federally insured thrift. After EPHC, Hughes, and El Paso entered into a merger agreement, El Paso sought authorization to convert from mutual to stock ownership, and EPHC sought approval to acquire control of El Paso. EPHC proposed that it would purchase all of El Paso's common stock by contributing $11.5 million in cash and 14 properties that it would obtain from their owners in exchange for stock. EPHC subsequently amended its application to propose the sale of $10 million in Class A debt to two partnerships and $1.5 million in Class B debt to Hughes in his personal capacity. Among the forbearances, waivers, and approvals that EPHC sought was permission for the thrift, in calculating its capital for regulatory purposes, to amortize the supervisory goodwill arising from the purchase over a 25-year period. Pet. App. 2a-4a, 6a, 21a-22a.

In 1988, the Federal Home Loan Bank Board (FHLBB) conditionally approved El Paso's application to convert, authorized EPHC to acquire control of El Paso, and sent a letter to El Paso granting various forbearances, including the 25-year amortization of goodwill (Forbearance Letter). In a separate letter, the

FHLBB granted regulatory approval but conditioned the approval on compliance with all applicable federal regulations, which included a requirement that controlling shareholders enter into a capital maintenance agreement (Approval Letter). Pet. App. 4a, 14a.

In accordance with this approval, on May 27, 1988, the day of the closing, the Federal Saving and Loan Insurance Corporation (FSLIC) and EPHC executed the Regulatory Capital Maintenance Dividend Agreement (Dividend Agreement). EPHC agreed that:

> [I]n consideration of the FSLIC approving the acquisition of control of El Paso . . . [EPHC] will cause the Regulatory Capital of [the Resulting Institution] to be maintained at a level at or above the Regulatory Capital Requirement and as necessary, will infuse sufficient additional capital . . . to effect compliance with such requirement.

Pet. App. 5a (second set of brackets in orginial). The Dividend Agreement also provided that "[a]ll references to regulations of the [FHLBB] or the FSLIC used in this Agreement shall include any successor regulation thereto." *Ibid.* El Paso converted from mutual to stock ownership, and EPHC acquired the thrift and changed its name to El Paso Savings Association (EPSA). In an Agreement of Obligation, also executed on the day of the closing, Hughes promised EPSA that the contributed real estate would produce at least $1 million in annual cash flow and that Hughes would make up any shortfall. *Id.* at 4a-5a, 62a.

2. In August 1989, Congress enacted FIRREA to address widespread problems in the savings and loan industry. FIRREA created the Office of Thrift Supervision (OTS) and charged it with examining, supervising,

and regulating federally insured thrifts. 12 U.S.C. 1462a, 1463. FIRREA gave the Director of OTS the authority to appoint a conservator or receiver for any insured thrift if the Director determined, in the exercise of his discretion, that one or more bases for seizure of the thrift existed. 12 U.S.C. 1464(d)(2)(A), 1821(c)(5). FIRREA also imposed new capital requirements on thrifts and restricted their ability to count supervisory goodwill toward those capital requirements. FIRREA thus altered the term over which EPSA could amortize the goodwill generated by EPHC's acquisition of El Paso. EPSA became insolvent and unable to meet its capital requirements. In September 1990, OTS placed EPSA into receivership. Pet. App. 27a-28a.

3. On September 5, 1990, EPHC and Hughes filed a complaint in the Court of Federal Claims alleging that, by enacting FIRREA, the government had breached a contract promising petitioners that EPSA could count as regulatory capital the goodwill created by EPHC's acquisition of El Paso. Pet. App. 7a.

The trial court initially granted summary judgment in favor of petitioners on liability. Pet. App. 16a-71a. Petitioners argued (see *id.* at 31a), and the trial court agreed, that no single document constituted a contract regarding the FHLBB's grant of permission to amortize the goodwill over 25 years. Instead, the court concluded that a series of documents—including the Approval Letter, the Forbearance Letter, the Agreement of Obligation, and the Dividend Agreement—together encompassed a single, "overall contract" to which both petitioners were parties. *Id.* at 67a, 69a-70a; see *id.* at 11a.

Later, however, in conjunction with its determination of damages, the trial court reconsidered its liability decision. Pet. App. 72a-177a. Based upon intervening

Federal Circuit precedents, the court concluded that, under the language in the Dividend Agreement, EPHC had assumed the risk of a change in regulatory capital requirements. Accordingly, FIRREA did not constitute a breach of the agreement between the government and EPHC. *Id.* at 168a; see *id.* at 177a (dismissing EPHC's claims). Although the trial court reaffirmed its earlier conclusion that there was one "overarching contract" comprising numerous documents, the court nonetheless held that the Dividend Agreement, which contained the assumption of risk provision, was "separate" from the other documents constituting the contract. *Id.* at 175a. Because Hughes had not signed the Dividend Agreement, the trial court held that Hughes had not assumed the risk of regulatory change, and was entitled to compensation for breach of the overall contract. *Id.* at 176a-177a. The court awarded him $46.5 million. *Id.* at 177a.

4. The court of appeals affirmed in part and reversed in part. Pet. App. 1a-15a. The court first considered and rejected EPHC's cross-appeal, holding that the trial court correctly determined that EPHC had assumed the risk of a change in the regulations governing regulatory capital. *Id.* at 8a-10a. The court explained that the Dividend Agreement stated that "[a]ll references to regulations of the Board or the FSLIC used in this Agreement shall include any successor regulation thereto, it being expressly understood that subsequent amendments to such regulations may be made and that such amendments may increase or decrease the Acquiror's obligation under this Agreement." *Id.* at 8a. The court observed that this language was identical to contractual language considered in *Admiral Financial Corp.* v. *United States*, 378 F.3d 1336, 1339 (Fed. Cir. 2004), and *Franklin Federal Savings Bank* v. *United*

States, 431 F.3d 1360, 1369 (Fed. Cir. 2005). The court noted that, in those cases, it had concluded that this language placed on the private party to the contract the risk that regulations might change and alter the terms of the agreement. Adhering to that precedent, the court held that EPHC had assumed the risk of regulatory change and therefore could not recover for breach of contract based on the enactment of FIRREA. Pet. App. 8a-10a.

In reaching that holding, the court rejected EPHC's attempt to distinguish *Admiral* and *Franklin* based on its contention that the goodwill forbearance was the only consideration provided by the government in this case. Pet. App. 9a-10a. EPHC argued that, if the government could retract the goodwill forbearance at any time, then its promise under the contract was "illusory." *Id.* at 9a. The court of appeals rejected that argument on two grounds. First, the court stated, under *Winstar*, a promise for a regulatory waiver until regulatory change occurs can be sufficient consideration to support a contract. *Id.* at 10a. Second, the court stressed, the goodwill forbearance was not the only consideration here. The Dividend Agreement expressly described regulatory approval of the transaction as the government's contribution, and that approval alone, the court concluded, was sufficient consideration. *Ibid.*

The court of appeals next addressed the government's appeal of the award of $46.5 million to Hughes. The court reversed the award on the ground that Hughes, like EPHC, had assumed the risk of regulatory change. Pet. App. 10a-15a. The court concluded that all of the transaction documents—including the Approval Letter, the Forbearance Letter, and the Dividend Agreement—were part of one overall contract. *Id.* at

15a. That conclusion, the court explained, was supported by the common subject matter of the documents, their numerous cross-references to one another, and the timing of their execution. *Id.* at 12a, 14a-15a & n.2. For example, the court noted, the Approval Letter required compliance with all relevant regulations, which in turn required execution of a capital maintenance agreement, such as the Dividend Agreement. *Id.* at 14a. The Dividend Agreement stated that it was in consideration for the government's approval of the acquisition, which was contained in the Approval Letter. *Ibid.* And the Approval Letter specifically authorized issuance of the Forbearance Letter, which in turn stated that it was issued in connection with the approval of the acquisition. *Id.* at 14a-15a. Because there was only one contract, the court concluded that, if Hughes was a party to that contract at all, he was subject to its risk-allocation term, and he therefore could not recover for breach of contract based on FIRREA. *Id.* at 15a.

ARGUMENT

The court of appeals correctly rejected petitioners' breach-of-contract claims based upon its interpretation of the asserted contract. Its ruling is consistent with this Court's decision in *Winstar* and does not conflict with any decision of this Court or any other court of appeals. This Court's review is therefore not warranted.

1. Petitioners contend (Pet. 15-22) that the court of appeals "misread" *Winstar* and "applied errant principles of contract law" when it interpreted the alleged contract to contain a government promise of goodwill forbearance with the risk of regulatory change on petitioners. Pet. 15. That contention is incorrect and does not warrant this Court's review.

Petitioners argue (Pet. 15-19) that the court of appeals' interpretation renders the government's consideration "illusory," and that the court's opinion therefore conflicts with Justice Scalia's concurring opinion in *Winstar* and the contract law on illusory promises on which he relied. That argument, however, rests on the mistaken premise that the promise of goodwill forbearance was the only consideration provided by the government. See Pet. 18. Contrary to that premise, the court of appeals held that regulatory approval of the acquisition was additional consideration provided by the government. See Pet. App. 10a. Indeed, as the court of appeals noted (*ibid.*), the Dividend Agreement expressly stated that EPHC's promise to maintain capital levels was made "in consideration of the FSLIC approving the acquisition of control of El Paso." *Id.* at 5a. The court of appeals also correctly held that regulatory approval was adequate consideration to support the alleged contract. See *id.* at 10a. Because there was ample consideration independent of the promise of goodwill forbearance, there is no conflict with Justice Scalia's concurring opinion or contract law principles concerning illusory consideration. See, *e.g.*, 1 E. Allan Farnsworth, *Farnsworth on Contracts* § 2.13, at 133 n.1 (3d ed. 2004) (explaining that an illusory promise only prevents the existence of a contract when "there is no consideration other than the promise in question to support the other party's promise").[1]

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[1] In holding that regulatory approval provided adequate consideration, the court of appeals necessarily reversed the trial court's finding that goodwill forbearance was the only consideration provided (Pet. App. 128a) and its related determination that, "absent the goodwill forbearance, all [petitioners] received was a multi-million dollar debt that was not bargained-for and was not worth a peppercorn" (*id.* at 131a-

Petitioners dispute (Pet. 20-21) the court of appeals' conclusion that regulatory approval was sufficient consideration, but that fact-bound disagreement does not warrant this Court's review. In any event, the court of appeals was correct. Petitioners minimize the value of regulatory approval by mischaracterizing the nature of the acquisition. Petitioners obtained control of a valuable thrift franchise by providing it with debt-encumbered properties. As a result, petitioners were able to retain control of those assets while using the thrift's funds to resolve the debts. Indeed, the thrift paid off debts for which petitioner Hughes was personally liable. Pet. App. 21a, 118a, 126a. Regulatory approval thus provided petitioners a valuable benefit.

Petitioners also ignore the fact that the goodwill forbearance was only one of several that the government granted in connection with the approval. Pet. App. 83a. The government also granted a forbearance terminating the supervisory agreement that previously had constrained El Paso's operations. *Id.* at 85a. That forbearance, fully performed at the time the acquisition was completed, provided consideration even in the face of the risk-allocation language of the Dividend Agreement. Another forbearance addressed potential failures by EPSA to meet regulatory net worth requirements due to "an increase in the contingency factor attributable to El Paso" on the acquisition date. *Id.* at 84a. EPSA was also permitted to "exclude all investments currently in El Paso's portfolio in determining the amount available for equity risk investments." *Ibid.* Further, EPSA was

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132a), on which petitioners rely (Pet. 18-19). As discussed in the text following this footnote, the disagreement between the trial court and the court of appeals on this fact-specific issue does not warrant this Court's review.

allowed to reduce its liquidity requirement below the amount required by regulation. *Id.* at 85a. In light of the additional forbearances associated with the regulatory approval, there can be no doubt that the approval was sufficient consideration for any contract that existed.[2]

Petitioners erroneously suggest (Pet. 21) that the court's holding that regulatory approval constituted adequate consideration conflicts with *D&N Bank* v. *United States*, 331 F.3d 1374 (Fed. Cir. 2003). Contrary to that suggestion, *D&N Bank* does not hold that regulatory approval cannot constitute consideration; rather, it holds that regulatory approval alone does not manifest the *intent to contract* necessary to establish a contract. *Id.* at 1378. Neither court below held that regulatory approval established the government's intent to contract here. Instead, the trial court found that various written documents, including the Forbearance Letter, manifested the intent to contract, Pet. App. 38a, and the court of appeals did not disturb that finding.

Finally, even if petitioners were correct that there was inadequate consideration under the court of appeals'

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[2] To support their claim that the "goodwill forbearance at issue in this case was the *only consideration* contributed by the government" (Pet. 18), petitioners cite trial testimony of former government employees. According to petitioners, those employees testified, many years after the transaction, that they were not "aware" "of any other obligation that the United States government was contractually required to perform." *Ibid.* That testimony, based upon the employees' personal memory, cannot undermine the court of appeals' holding that regulatory approval constituted additional and sufficient consideration— a holding that is amply supported by the express terms of the Dividend Agreement, which stated that regulatory approval was the consideration, and the Forbearance Letter, which detailed the numerous other forbearances provided by the government.

interpretation, their claim would not warrant review. If there was inadequate consideration, then there was no contract at all, and petitioners would still not be entitled to any relief. See *Caroline Hunt Trust Estate* v. *United States*, 470 F.3d 1044, 1049 (Fed. Cir. 2006) (no contract absent consideration). Because petitioners would not be entitled to relief even if their illusory-consideration contention were correct, it does not warrant this Court's review.[3]

2. a. Petitioners also incorrectly argue (Pet. 19-20, 27-30) that the court of appeals' decision conflicts with the *Winstar* plurality opinion. In fact, the *Winstar* plurality opinion affirmatively supports the decision of the court of appeals.

Petitioners erroneously contend (Pet. 19-20, 27-30) that the *Winstar* plurality rejected the possibility that a contract could promise goodwill forbearance only until regulatory change occurs. Contrary to that contention, the *Winstar* plurality explicitly acknowledged that a contract could expressly allocate to one of the parties the risk of regulatory change. Indeed, the plurality no-

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[3] Indeed, as the government argued below (see Gov't C.A. Br. 14 & n.2, reproduced at Pet. App. 178a), there was no contract regarding the treatment of goodwill in this case regardless of the consideration issue, because the government acted solely in a regulatory capacity when it approved EPHC's acquisition of EPSA without any assistance agreement. In *Winstar*, by contrast, there were admitted contracts (assistance agreements) with integration clauses that were held to incorporate regulatory resolutions and forbearances. See 518 U.S. at 862-865, 867. Moreover, as the government also argued below, Hughes was not a party to any contract on goodwill forbearance but instead participated in the transaction solely as an EPHC shareholder. See Gov't C.A. Br. 15-21. These arguments furnish additional grounds in support of the judgment below and additional reasons for the Court to deny review.

ted that contracts allocating that risk "are especially appropriate in the world of regulated industries, where the risk that legal change will prevent the bargained-for performance is always lurking in the shadows." *Winstar*, 518 U.S. at 869. Moreover, the plurality stated that, in the cases before it, "each side could have eliminated any serious contest about the correctness of their interpretive positions by using clearer language." *Id.* at 869 n.15. In support of that statement, the plurality cited *Guaranty Financial Services, Inc.* v. *Ryan*, 928 F.2d 994 (11th Cir. 1991) (*Guaranty*). The *Winstar* plurality noted that *Guaranty* had held, "based on very different contract language [from the language in the cases before the Court in *Winstar*], that the Government had expressly reserved the right to change the capital requirements without any responsibility to the acquiring thrift." *Winstar*, 518 U.S. at 869 n.15; see *Guaranty*, 928 F.2d at 999-1000. By citing *Guaranty* with approval, the *Winstar* plurality indicated that parties contracting with the government can expressly agree to accept the risk of regulatory change and thereby contract for a temporary regulatory forbearance. That is precisely what the court of appeals held that petitioners did here.

The *Winstar* plurality's approving citation of *Guaranty* also supports the court of appeals' holding in this case that language in the Dividend Agreement assigned the risk of regulatory change to petitioners. As both the trial court and the court of appeals noted, the Dividend Agreement's risk-allocation language is identical to language that the court of appeals, in *Admiral* and *Franklin*, construed to assign the risk of regulatory change to the private parties contracting with the government. Pet. App. 10a, 167a-168a. The language is likewise "identical" to the language that the Eleventh Circuit in-

terpreted the same way in *Guaranty*. See *Admiral*, 378 F.3d at 1339, 1343; *Franklin*, 431 F.3d at 1368-1371. Because the *Winstar* plurality cited *Guaranty*'s identical interpretation of identical language with approval, the *Winstar* plurality opinion supports the court of appeals' interpretation of the risk-allocation language at issue here.[4]

b. Petitioners further contend (Pet. 25-27) that the court of appeals' construction of the risk-allocation language is inconsistent with the court of appeals' decision that was affirmed in *Winstar*. As the court of appeals explained in *Franklin*, however, there is no conflict. The language at issue in this case and in *Franklin*, *Admiral*, and *Guaranty* is "quite different" from any language in the contracts at issue in *Winstar*. See *Franklin*, 431 F.3d at 1370; see also *Winstar*, 518 U.S. at 869 n.15 (plurality opinion).

3. Petitioners also argue that the court of appeals erred because it purportedly "construed a provision in the Approval Letter requiring petitioners' compliance with all applicable regulations as an open door through

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[4] Petitioners assert (Pet. 29 n.10) that, in citing *Guaranty*, the *Winstar* plurality did not address what language qualifies as clear enough to shift the risk of regulatory change to a private party. Contrary to that assertion, the plurality explicitly referred to the language that the Eleventh Circuit interpreted in *Guaranty* and stressed that the language differed significantly from the language in the cases before the Court in *Winstar*. See 518 U.S. at 869 n.15. Petitioners also assert that the *Winstar* plurality did not address "whether clear language could shift the risk of regulatory change to a private party when the result eliminated the only consideration provided by the government." Pet. 29 n.10. Even assuming that assertion is correct, it is irrelevant here. The risk-allocation language in petitioners' alleged contract did not eliminate the regulatory approval, which the court of appeals held was adequate consideration.

which virtually any regulatory requirement could be added to an already finalized agreement and trump its core provisions." Pet. 22-23. Even if petitioners' contention were correct, their fact-bound challenge to the court's construction of this particular contract would not warrant review—especially considering the dwindling number of *Winstar*-related cases.

In any event, petitioners' contention is not correct but is premised on a mischaracterization of the court of appeals' opinion. The court did not impose any obligations on petitioners based on the language in the Approval Letter requiring compliance with all relevant regulatory provisions. Instead, the court relied on that language as one factor among many in concluding that all of the documents concerning the El Paso acquisition were part of a single contract. See Pet. App. 14a. Moreover, the risk-allocation provision in the Dividend Agreement was not a "regulatory requirement" (Pet. 23) but a voluntary promise by petitioner to accept the risk of regulatory change. And the risk-allocation provision was not "added to an already existing agreement." *Ibid.* Both the trial court and the court of appeals held that the Dividend Agreement was part of the alleged overall contract. Pet. App. 14a-15a, 69a-70a. And the court of appeals found that the parties entered into that contract on the day that EPHC executed the Dividend Agreement, which was the same day that the acquisition closed and Hughes signed the Agreement of Obligation. *Id.* at 14a n.2. Finally, the risk-allocation provision did not "trump" the "core provisions" of the contract. Pet. 23. Petitioners' assertion that it did is based on the mistaken premise that it "eliminated the government's obligation to provide the contracted-for consideration." *Ibid.* As discussed above, the court appeals held that

there was ample additional consideration provided by the government, most notably approval of the El Paso acquisition. Far from "trump[ing]" the "core provisions" of the contract, the risk-allocation language was an integral part of the bargain allegedly struck between petitioners and the government.

Petitioner Hughes and the other shareholders in EPHC were highly experienced business people, represented by experienced counsel. Had petitioners objected to the risk-allocation provision, they could have walked away from the proposed transaction without any obligation to the government. Having elected to proceed with the acquisition upon the terms proposed by the government, they cannot now demand that the Court rewrite the risk-allocation provision to which they expressly agreed.

4. Petitioners additionally argue (Pet. 23-24) that the court of appeals erred in concluding that Hughes was bound by the risk-allocation provision, and they suggest that the Dividend Agreement was somehow a separate contract from the agreement on goodwill forbearance. That fact-bound contention does not warrant this Court's review.

As an initial matter, petitioners' argument is inconsistent with their position in the trial court, where they asserted that there was *one* contract that consisted of EPHC's application to acquire EPSA, FHLBB's letter approving the acquisition, the Forbearance Letter, and the Dividend Agreement. See Pet. App. 31a. The trial court agreed with petitioners' view. *Id.* at 39a, 67a, 69a-70a; see *id.* at 11a. The court of appeals likewise determined that "the series of contractual documents in this case constitute one overall agreement." *Id.* at 15a. There is no reason for this Court to revisit that fact-spe-

cific decision. See *Graver Tank & Mfg. Co.* v. *Linde Air Prods. Co.*, 336 U.S. 271, 275 (1949); *United States* v. *Johnston*, 268 U.S. 220, 227 (1925).

5. Finally, petitioners contend (Pet. 2-3, 30-34) that this Court's review is warranted because the Federal Circuit's decisions in the *Winstar* cases have undermined this Court's *Winstar* decision and will discourage citizens from entering into commercial contracts with the government. That contention is incorrect.

As the Federal Circuit has correctly observed, *Winstar* claims frequently turn on their particular facts and circumstances, and each case must be considered on its individual merits. See, *e.g.*, *California Fed. Bank, FSB* v. *United States*, 245 F.3d 1342, 1347 (2001), cert. denied, 534 U.S. 1113 (2002). Contrary to petitioners' implication (Pet. 31), some plaintiffs have been successful, while others have not. Cumulatively to date, plaintiffs in *Winstar*-related cases have been awarded over $1 billion, and the awards in individual cases have ranged from $2.05 million to $381 million. See *Hometown Fin., Inc.* v. *United States*, 409 F.3d 1360, 1362 (Fed. Cir. 2005); *Glendale Fed. Bank, FSB* v. *United States*, 378 F.3d 1308, 1312 (Fed. Cir. 2004), cert. denied, 544 U.S. 904 (2005).

In this case, as in *Franklin* and *Admiral*, petitioners were unable to make out their claim for breach of contract because they agreed to bear the risk of regulatory change. In other cases, relief has been denied based on findings that there was no contract, no standing, forfeiture for fraud, or a prior material breach. See *Long Island Sav. Bank, FSB* v. *United States*, 503 F.3d 1234, 1251, 1253 (Fed. Cir. 2007); *Anderson* v. *United States*, 344 F.3d 1343, 1359 (Fed. Cir. 2003); *D&N Bank*, 331

F.3d at 1382; *Castle* v. *United States*, 301 F.3d 1328, 1337 (Fed. Cir. 2002), cert. denied, 539 U.S. 925 (2003).

The Federal Circuit's decisions have not "marginalized" *Winstar* to benefit the government over private parties (Pet. 1), or, "by small bites, eclipsed *Winstar*" (Pet. 31), as petitioners contend. Rather, they have respected this Court's admonition that ordinary principles of contract construction and breach should be applied to government contracts. *Winstar*, 518 U.S. at 870-871, 895 (plurality opinion). Contrary to petitioners' apparent belief, the decision in *Winstar* did not command the Federal Circuit to issue a blank check to anyone who acquired a savings and loan during the 1980s.

In any event, the *Winstar* set of cases is nearing its end. Of the original 122 *Winstar*-related cases, only 19 remain, and none of the remaining cases concerns risk-allocation provisions. The issues raised by petitioners will thus have little, if any, future impact.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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IN THE

Supreme Court of the United States

ALFRED D. HUGHES AND EL PASO HOLDING CORPORATION,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

REPLY BRIEF FOR THE PETITIONERS

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IN THE

Supreme Court of the United States

No. 07-735

ALFRED D. HUGHES AND EL PASO HOLDING CORPORATION,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

REPLY BRIEF FOR THE PETITIONERS

The Government's Opposition characterizes a remarkable legal ruling of the Federal Circuit, that contravenes both established principles of law and

decisions of this Court, as "factual" and without prospective effect. That is not a fair reading. The trial court heard the evidence and, largely on the testimony of the government's own witnesses, concluded that the only consideration provided by the government was the goodwill forbearance. The Federal Circuit did not alter this conclusion or dispute the facts that supported it. Instead, it fashioned a new principle of law, that "regulatory approval" by itself is enough to sustain a contract. The facts of the case, accordingly, are not at issue. The petition presents for the Court's review the pure legal question whether regulatory approval alone is sufficient to sustain a contract.

Justice Scalia, in his concurrence in *United States v. Winstar Corp.*, 518 U.S. 839 (1996), made it clear that the answer to this question is no. Joined by Justices Kennedy and Thomas, he observed that

notwithstanding regulatory approval, the government's agreement to grant a forbearance for only so long as it wished was an "absolutely classic description of an illusory promise" that vitiated the contract. 518 U.S. at 921. The Federal Circuit, which understood that its novel principle of law regarding regulatory approval ran headlong into Justice Scalia's reasoning, candidly dismissed Justice Scalia's point by stating that "[i]n our view, Justice Scalia's position, far from representing the majority view, itself is a minority view on this particular issue." Pet. App. 10a. The Solicitor General, presumably unwilling to fully endorse the Federal Circuit's pronouncement on regulatory approval, gives lip service to the court of appeals' ruling, and then asserts that other consideration was provided in this case – an argument that has no basis in the

record, was rejected by the trier of fact, and was never even presented to the Federal Circuit.

The Solicitor General also contends that this case has little prospective application because the *Winstar* cases, a result of the 1980s savings and loan industry collapse, are nearly at an end. This overlooks the fact that history repeats itself. It is true that after 20 years of litigation these cases are dwindling. However, the government's willingness to repudiate its obligations whenever it appears expedient to do so will haunt it, unless the Court intervenes. Today's headlines already proclaim the newest financial crisis involving subprime mortgages. As we write, delinquencies and foreclosures are rising, and the Chairman of the Board of Governors of the Federal Reserve has implored financial institutions to make accommodations and concessions to subprime

borrowers, in order to avert a national financial crisis. If the past is prologue, then the rulings of the Federal Circuit in the *Winstar* cases, embodying the novel principles of law it employs only against those who sue the government, and the government's shameless handling of the *Winstar* cases, will make private parties reluctant to join hands with the government in other bail-out ventures.

I. REGULATORY APPROVAL IS NOT CONSIDERATION.

The government characterizes the court of appeals' ruling, that regulatory approval is adequate consideration, as a "fact-bound disagreement that does not warrant this Court's review." Op. at 9. However, the question whether regulatory approval is sufficient to sustain a contract, when the government has eliminated the bargained-for consideration, is a legal issue. There are no facts in

dispute: the trial court found that the only consideration bargained for, or received, was the goodwill forbearance and the court of appeals did not disturb that ruling.

Until its one sentence ruling in this case, the Federal Circuit consistently rejected, as a matter of law, arguments that a contract with the government was formed when a federal agency granted its approval for an acquisition. *See First Commerce Corp. v. United States*, 335 F.3d 1373 (Fed. Cir. 2003) (declining to find a contract based on regulatory approval alone); *Fifth Third Bank of W. Ohio v. United States*, 402 F.3d 1221, 1234 (Fed. Cir. 2005) ("[m]ere approval of a merger by the FHLBB, acting solely in its regulatory capacity, did not create contractual obligations."). In changing its mind in this case, the Federal Circuit failed to acknowledge its own previous contrary rulings, failed to explain its

reasoning, and failed to support its pronouncement with any case law. The Federal Circuit did understand, however, that there was no way to harmonize its views with those of Justices Scalia, Kennedy and Thomas. Accordingly, it dismissed their contrary conclusion in *Winstar* as an aberrant "minority view."

The Solicitor General similarly declines to support his position except in the most superficial and unconvincing manner. He states that "regulatory approval was adequate consideration to support the alleged contract," Op. at 8, but goes no further, in terms of legal analysis, than this unsupported assertion. Instead, he mischaracterizes what occurred in this case. He asserts that by obtaining regulatory approval the Petitioners "obtained control of a valuable thrift franchise by providing it with debt-encumbered properties. As a

result, petitioners were able to retain control of those assets while using the thrift's funds to resolve the debts. Indeed, the thrift paid off debts for which petitioner Hughes was personally liable." Op. at 9. What the Solicitor General fails to acknowledge is that it was not even contested in the court of appeals that the net value of the real estate contributed was $35 million, which was in addition to $11.5 million in subordinated debt that Hughes purchased.

Further, to assert that Petitioners obtained control of "a valuable thrift franchise" is wishful thinking. The goodwill forbearance raised El Paso from insolvency; the chief government negotiator and senior official testified that without the goodwill forbearance El Paso "would never have been allowed to open." Pet. App. 131a. Petitioners acquired a bankrupt institution that would not have survived, indeed would not been allowed to open its doors, had

Petitioners not accepted in good faith the government's offer of a goodwill forebearance, and in return for that sole consideration proceeded to merge the old institution into a new thrift, and to infuse tens of millions of dollars in property and other assets to that new institution.

Moreover, the debt pay-off on the property was not provided by the government but by the financial institution owned by the Petitioners. As the trial court correctly ruled, "to the extent Hughes and/or the Holding Company benefited from the thrift's payment of debt on the property . . . those benefits were neither received from the government nor paid as a requirement of the contract." Pet. App. 128a. In any event, there was no *net* benefit to the Petitioners, for Petitioners' asset, El Paso, paid the debt and was

diminished by the amount of the pay-off.[1] Finally, in this lawsuit Hughes only seeks to recover his net equity contribution. Accordingly, whether debt was paid on the properties contributed to El Paso, and by whom, is irrelevant.

Apart from this mischaracterization of the record, the government does not muster a single legal argument in support of its novel principle of contract law, applicable only to the government, that mere regulatory approval is consideration. The government does not acknowledge that, in *Winstar*, the Court confronted a situation virtually identical to that here, and yet notwithstanding regulatory approval, *and* an assistance agreement by which the government contributed cash to the financial institution, the Court concluded that the withdrawn

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[1] Under the government's logic, giving a dollar and receiving back five cents means that the payor is receiving

goodwill forbearance constituted an illusory promise. Asserting that regulatory approval should take on a new life as consideration, therefore, also contradicts the plurality ruling in *Winstar*.

II. BECAUSE THE ONLY CONSIDERATION IN THIS CASE WAS A GOODWILL FORBEARANCE, THE FEDERAL CIRCUIT WAS REQUIRED TO READ THE AGREEMENT TO AVOID FINDING AN ILLUSORY PROMISE.

1. In an attempt to avoid admitting that the only consideration in this case was the goodwill forbearance, the government contends that the goodwill forbearance "was only one of several [forbearances] that the government granted in connection with the approval." Op. at 9. It asserts that there was sufficient consideration in light of these additional forbearances. Op. at 10.

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consideration because he is receiving a nickel.

This response of the government cannot be credited. First, to make its argument with respect to the additional forbearances, the government has been forced to renounce the testimony of its own witnesses at trial that the only bargained-for consideration was the goodwill forbearance and that, without this forbearance, the new thrift would never have been permitted to open its doors. Op. at 10 n.2. As the government's lead negotiator and senior regulator, James Satterfield, testified under oath, the goodwill forbearance was the only obligation the government was contractually obligated to provide. Pet. App. 130a. In addition, "El Paso would never have been allowed to open" without the goodwill forbearance, since it would have been insolvent and subject to immediate seizure. *Id.* Another federal regulator, Janet Hovey, testified similarly. Pet. App. 131a. It is black-letter law that consideration

consists of a bargained-for promise or performance. Restatement (Second) of Contracts § 71 (1981). The only bargained for consideration in this case was the goodwill forbearance, and the government errs by claiming otherwise.

Second, it is undisputed that the sum total of the alleged additional forbearances would not even satisfy the peppercorn test for consideration. As the trial court ruled, "the other forbearances [] are or were of value only if the thrift was open . . . . Remove the goodwill forbearance from the bundle of forbearances and there is no bundle at all." Pet. App. 132a.

Finally, the government never argued before the Federal Circuit that additional forbearances constituted consideration, and the Federal Circuit decision makes no reference to this matter. This Court does not consider points raised by a

respondent, when those matters were not presented to the court below. *Glover v. United States*, 531 U.S. 198, 205 (2001); *Ryder v. United States*, 515 U.S. 177, 184 n.4 (1995).

2. The government also errs in the facile argument that even if the consideration provided was illusory, that would only mean no contract was formed and thus Petitioners would not be entitled to any relief. Op. at 11. The government quite obviously misstates Petitioners' argument. Petitioners do not contend there was no contract but that the Federal Circuit was obligated to construe the contract in a manner that avoided an illusory promise. When presented with an illusory promise, a court may either find the promise unenforceable or, read substance into the promise to prevent it from being illusory. 1 E. Allan Farnsworth, *Farnsworth on Contracts* § 2.13 (3d ed. 2004). Courts are to

choose the latter course, where possible. *Id*; *see also Cherokee Nation v. Leavitt*, 543 U.S. 631 (2005) (rejecting construction that would have made contract illusory); *Mobil Oil Exploration & Producing Se., Inc. v. United States*, 530 U.S. 604, 620 (2000) (affirming a contract interpretation that would not "render the bargain illusory") (quotations omitted).

Here, the Federal Circuit could have preserved the contract by a reasonable reading of the risk-of-regulatory change provision contained in the Regulatory Capital Maintenance Dividend Agreement, or by viewing the RCMDA as a separate contract that did not affect the supervisory goodwill forbearance. The Federal Circuit, accordingly, could have concluded that the provision only required compliance with required regulatory capital levels, as the name of the document itself suggests, even if those capital requirements changed in the future, but

did not obligate Petitioners to assume the risk that the consideration that formed the basis of the bargain would be eliminated by the government, at its whim, at a subsequent date. Such a reading, which is the very reading given the provision by the trial court, would have been consistent with the Court's *Winstar* decision. The *Winstar* plurality recognized what Justice Souter characterized as the "madness" of construing a contract to require a party to assume the risk of regulatory change when, without the goodwill forbearance, the acquired thrift would immediately fail. 518 U.S. at 863-64.

The government contends that the *Winstar* plurality decision "affirmatively supports the decision of the court of appeals." Op. at 11. It asserts that the plurality recognized that a contract could allocate to one of the parties the risk of regulatory change, and in support of that principle, cited with approval

the Eleventh Circuit's decision in *Guaranty Financial Services, Inc. v. Ryan*, 928 F.2d 994 (11th Cir. 1991). This discussion, in a footnote to the plurality opinion, 518 U.S. at 869 n. 15, does not carry the meaning the government assigns it. Despite the plurality's oblique reference to the Eleventh Circuit's decision in *Guaranty*, the plurality decision did not address the issue presented here, which is whether language in an agreement, less than clear, could shift the risk of regulatory change to a private party when such a shift would eliminate the only consideration provided by the government.[2] However, the plurality ruling in *Winstar*, and Justice Scalia's concurrence, strongly

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[2] The government claims that whether the Court addressed the issue is irrelevant because "[t]he risk allocation language in petitioners' alleged contract did not eliminate the regulatory approval, which the court of appeals held was adequate consideration." Op. at 13 n.4. We have already shown that the regulatory approval argument is without merit and in fact is the very argument that the Solicitor General declined to make in the past.

indicate that the Court's answer to this question, if directly presented, would be no. *See Franconia Assocs. v. United States,* 536 U.S. 129, 142 (2002) (rejecting the Federal Circuit's interpretation of contracts established by a statutory scheme when that interpretation would render the government's obligation "meaningless," and would result in a contract that was illusory). The government's argument, based on the *Winstar* footnote, should be rejected.

III. THE FEDERAL CIRCUIT'S NEW GOVERNMENT-FRIENDLY CONTRACT RULES CAN BE APPLIED TO ANY CONTRACT WITH THE GOVERNMENT AND THUS WILL HAVE A SIGNIFICANT PROSPECTIVE EFFECT.

The government attempts to cabin the Federal Circuit's wayward rulings by asserting that because they arise in a *Winstar* case, they have no prospective application. However, the legal issues presented

here are not confined to *Winstar* cases but have broad application. The current sub-prime mortgage crisis, which is widely predicted to be more severe than the savings and loan crisis of the 1980s, is a reminder that the government must from time-to-time seek the aid of its citizens' private capital. To do so, the government typically offers some form of regulatory flexibility or forbearance. Expanding the government's ability to avoid its contractual obligations, as the Federal Circuit has done here, "undermin[es] the Government's credibility at the bargaining table and increase[s]the cost of its engagements." *Winstar*, 518 U.S. at 884. The rulings of the Federal Circuit in this case, accordingly, will affect a wide variety of agency actions and will prove adverse to the government's own interests, as it attempts to muster private parties to solve important national problems.

CONCLUSION

The petition for a writ of certiorari should be granted. The Court may wish to consider summary reversal of the court of appeals' judgment and reinstatement of the well-reasoned decision of the trial court.

Respectfully submitted,

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